

If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Sinopec Zhenhai Refining & Chemical Company Limited, you should at once hand this circular and the enclosed proxy form to the purchaser or the transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or the transferee.

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中國石化鎮海煉油化工股份有限公司

SINOPEC ZHENHAI REFINING & CHEMICAL COMPANY LIMITED

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

(Stock Code: 1128)

CONTINUING CONNECTED TRANSACTIONS

Independent financial adviser to the Independent Board Committee and Independent Shareholders



博大資本國際有限公司

Partners Capital International Limited

A letter from the Independent Board Committee is set out on page 25 of this circular. A letter from Partners Capital to the Independent Board Committee and Independent Shareholders is set out on pages 26 to 40 of this circular.

A notice convening an Extraordinary General Meeting of Sinopec Zhenhai Refining & Chemical Company Limited to be held at 10:30 a.m. on 11 November 2005 at the conference room on the 1st Floor of Donghai Hotel at the Company's premises at Zhenhai District, Ningbo Municipality, Zhejiang Province, the People's Republic of China is set out on pages 41 to 43 of this circular.

If you intend to attend the Extraordinary General Meeting, please complete and return the enclosed reply slip in accordance with the instructions printed thereon as soon as possible and in any event by 5:00 p.m. on 21 October 2005.

Whether or not you are able to attend the Extraordinary General Meeting, please complete and return the enclosed proxy form in accordance with the instructions printed thereon as soon as possible and in any event by 10:30 a.m. on 10 November 2005. Completion and delivery of the proxy form shall not preclude you from attending and voting at the Extraordinary General Meeting or any adjournment thereof should you so wish.

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EXPECTED TIMETABLE

Deadline for returning the reply slips
for the Extraordinary General Meeting 5:00 p.m. on 21 October 2005

Deadline for returning the proxy forms
for the Extraordinary General Meeting 10:30 a.m. on 10 November 2005

Extraordinary General Meeting 10:30 a.m. on 11 November 2005

DEFINITIONS

In this circular, unless the context requires otherwise, the following terms and expressions shall have the following meanings:

“Associate(s)”	has the meaning given to it by the Listing Rules
“Board”	the board of directors of the Company
“Caps”	the maximum amount of each of the Continuing Connected Transactions for the three years ending 31 December 2007, details of which are set out in the section headed “Continuing Connected Transactions” in this circular
“Company”	Sinopec Zhenhai Refining & Chemical Company Limited (中國石化鎮海煉油化工股份有限公司), a joint stock limited company established in the PRC and listed on the Main Board of the Hong Kong Stock Exchange
“Comprehensive Services Framework Agreement”	the Framework Agreement dated 19 August 2005 entered into between the Company and Sinopec Group Company on the provision of certain services by Sinopec Group Company and its associates
“Connected person”	has the meaning given to it by the Listing Rules
“Continuing Connected Transactions”	the on-going connected transactions listed in Section 2.1 of this circular and to be conducted by the Company and Sinopec Group Company, Sinopec Corp and their associates
“Director(s)”	director(s) of the Company, including independent non-executive directors
“EGM” or “Extraordinary General Meeting”	an extraordinary general meeting of the Company to be held to approve, inter alia, the Continuing Connected Transactions
“Framework Agreements”	Comprehensive Services Framework Agreement and Mutual Supply Framework Agreement
“Group”	The Company and its subsidiaries
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“Hong Kong”	Hong Kong Special Administrative Region of the PRC
“Hong Kong Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Independent Board Committee”	the committee of independent non-executive Directors, consisting of Qiu Yun, Sun Yongsun, Cen Kefa and Li Linghong
“Independent Shareholders”	Shareholders other than Sinopec Corp and its associates

DEFINITIONS

“Latest Practicable Date”	9 September 2005, being the latest practicable date prior to the printing of this circular for ascertaining certain information in this circular
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“Mutual Supply Framework Agreement”	the Framework Agreement dated 19 August 2005 entered into between the Company and Sinopec Corp on the purchases and sales of certain raw materials, petroleum products and petrochemical products and services
“Non-Exempt Continuing Connected Transactions”	the on-going connected transactions (1), (2), (3), (4) and (5) listed in Section 2.1 and to be conducted by the Company and Sinopec Group Company, Sinopec Corp and their associates
“Partners Capital”	Partners Capital International Limited, a licensed corporation to carry on types 1 and 6 regulated activities (dealing in securities and advising on corporate finance) under the SFO, the independent financial adviser to the Independent Board Committee and Independent Shareholders
“PRC”	the People’s Republic of China
“PX”	paraxylene
“RMB”	Renminbi, the lawful currency of the PRC
“SECCO”	Shanghai SECCO Petrochemical Company Limited (上海賽科石油化工有限公司), a limited liability company incorporated in Shanghai
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Shareholders”	the holder(s) of the Shares
“Shares”	share(s) of RMB1.00 each in the capital of the Company
“Sinopec Corp”	China Petroleum & Chemical Corporation (中國石油化工股份有限公司), a joint stock limited company established in the PRC and listed on the Main Board of the Hong Kong Stock Exchange as well as in New York, London and Shanghai
“Sinopec Group Company”	China Petrochemical Corporation (中國石油化工集團公司), a wholly State-owned company established in the PRC
“Supervisor(s)”	supervisor(s) of the Company
“tpa”	tonnes per annum

DEFINITIONS

“Yizheng” Sinopec Yizheng Chemical Fibre Company Limited (中國石化儀征化纖股份有限公司), a joint stock limited company incorporated in the PRC whose H shares are listed on the Hong Kong Stock Exchange and listed A shares are traded on the Shanghai Stock Exchange

“%” per cent

Note: Solely for reference purpose, this circular contains translations of certain RMB amounts into HK\$ at the rate of RMB1.04 to HK\$1.00. It should not be construed that these translations are representations that RMB amounts could actually be converted into any HK\$ at the rates indicated or at all.

LETTER FROM THE CHAIRMAN



中國石化鎮海煉油化工股份有限公司
SINOPEC ZHENHAI REFINING & CHEMICAL COMPANY LIMITED

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

(Stock Code: 1128)

Executive Directors:

Sun Weijun
Zhan Juping
Xu Liqiao
Sun Jianli
Yu Renming

Registered Office:

Zhenhai District
Ningbo Municipality
Zhejiang Province
The People's Republic of China
Postcode: 315207

Non-executive Directors:

Wang Lisheng
Hu Weiqing

Independent Non-executive Directors:

Sun Yongsen
Cen Kefa
Li Linghong
Qiu Yun

16 September 2005

To the Shareholders

Dear Sir or Madam,

CONTINUING CONNECTED TRANSACTIONS

1. INTRODUCTION

The Company was granted waivers from strict compliance with the relevant provisions of the Listing Rules by the Hong Kong Stock Exchange with respect to certain Continuing Connected Transactions with Sinopec Group Company and its associates referred to in the prospectus published at the time of the Company's initial public offer on 15 November 1994. These connected transactions included purchases of domestic crude oil and other raw materials, import of crude oil, sales of refined products or by-products, research and development arrangements, insurance arrangements and carrying out of construction and overhaul of production and other facilities.

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The Hong Kong Stock Exchange subsequently confirmed prior to February 2000 when Sinopec Group Company, formerly a substantial shareholder having a direct interest in the Company, underwent a major reorganisation to establish Sinopec Corp, that these waivers would remain valid following such reorganisation.

As a result of recent changes to the Listing Rules, these waivers are no longer valid and the Company must comply with the relevant Listing Rules requirements for it to continue conducting the Continuing Connected Transactions previously subject to waivers.

In addition, the Company proposes to enter other Continuing Connected Transactions in respect of the agency sales of products, financial services and land management and leasing with Sinopec Corp and Sinopec Group Company.

On 19 August 2005, the Company entered into the Mutual Supply Framework Agreement and the Comprehensive Services Framework Agreement with Sinopec Corp and Sinopec Group Company, respectively, in respect of the Continuing Connected Transactions.

The purchases of raw materials, sales of products and services, construction and overhaul services and financial services whose relative applicable ratios exceed 2.5% constitute Non-Exempt Continuing Connected Transactions and subject to reporting, announcement and Independent Shareholders' approval. Agency sales of products, whose relevant applicable ratio exceed 0.1% but less than 2.5%, are also Non-Exempt Continuing Connected Transactions as they are aggregated in the same category of sales of products and services. Insurance services, research and development services, as well as land management and leasing services, whose relevant applicable ratios exceed 0.1% but less than 2.5%, constitute Continuing Connected Transactions subject to reporting and announcement.

The Independent Board Committee has been set up to advise the Independent Shareholders on the terms of the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps). Partners Capital has been appointed as the independent financial adviser to the Independent Board Committee and Independent Shareholders. The recommendation of the Independent Board Committee and the advice of Partners Capital are also included in this circular.

The purpose of this circular is (i) to provide you with further information on the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps); (ii) to set out the opinions and recommendations of the Independent Board Committee and Partners Capital; and (iii) to give you notice of the EGM at which the resolution set out therein will be proposed. An EGM will be held on 11 November 2005 for the purpose of, inter alia, obtaining the approval from the Independent Shareholders for the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) by way of poll. Sinopec Corp and its associates will abstain from voting at the EGM.

Notice of the Extraordinary General Meeting is set out on pages 41 to 43 in the circular.

LETTER FROM THE CHAIRMAN

2. CONTINUING CONNECTED TRANSACTIONS

2.1 Overview

On 19 August 2005, the Company and Sinopec Corp entered into the Mutual Supply Framework Agreement. On the same day, the Company and Sinopec Group Company entered into the Comprehensive Service Framework Agreement. The Framework Agreements, which govern the Continuing Connected Transactions, will expire on 31 December 2007.

Sinopec Corp and its associates will be the counter-parties of the Continuing Connected Transactions under the Mutual Supply Framework Agreement. Sinopec Group Company and its associates will be the counter-parties of the Continuing Connected Transactions under the Comprehensive Services Framework Agreement.

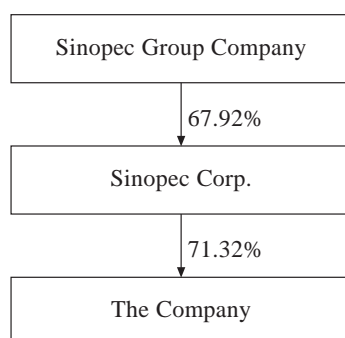
The table below sets forth a summary of the Mutual Supply Framework Agreement and the Comprehensive Services Framework Agreement:

Category of connected transaction	Segment by product or activity	Historical figures (in RMB million) for the years ending 31 December			Estimated amounts (in RMB million) for the years ending 31 December			
		2002	2003	2004	2005	2006	2007	
Mutual Supply Framework Agreement								
(1)	Purchases of raw materials	Crude oil and other raw materials, auxiliary materials, power and fuel, and services	5,765	8,311	14,928	37,619	55,192	78,965
(2)	Sales of products and services	Sale of refined products, intermediate petrochemical products and other petroleum refined by-products	14,575	21,365	32,124	53,973	74,622	102,155
(3)	Agency sales of products	Commission	0	0	0	74	153	192
Comprehensive Services Framework Agreement								
(4)	Construction and overhaul services	Construction and overhaul of production and other facilities	383	1,178	788	3,100	12,170	13,434
(5)	Financial services	Deposits and related interest income	0	0	0	1,752	1,902	1,952
(6)	Insurance services	Insurance premium expenses	41	45	54	56	66	83
		Safety funds received	19	18	17	20	25	33
(7)	Research and development services	Research and development expenses	35	35	0	35	35	35
		Research and development subventions received	5	8	0	10	12	18
(8)	Land management and leasing services	Operating lease expenses	0	0	13	15	29	36

2.2 Connected persons and their Relationships

Sinopec Corp holds approximately 71.32% equity interest of the Company's issued share capital and is the controlling shareholder of the Company. Sinopec Group Company is the ultimate parent of the Company. Principal operations of Sinopec Corp and Sinopec Group Company, together with their associates, are exploration, extracting and sale of crude oil and natural gas; pipe transportation of crude oil and natural gas; oil refining; production, sale and transportation of petrochemical, fibre and other chemical products, wholesaling, retailing, storage and transportation of oil products and other petroleum products; operation of convenient stores; production of electricity; production and installation of machineries; design and construction; purchase and sale of raw materials, coal, equipment and apparatus; production and management of equipment; research, development and application of technologies and information; import and export business; transfer of technology and labour.

The ownership and controlling relationship between the Company and ultimate parent are set out below:



The Company and each of the connected persons involved in the Continuing Connected Transactions (except where the connected party is Sinopec Group Company) are owned by the same ultimate parent, Sinopec Group Company, either directly or indirectly.

2.3 Background, Reasons for Transactions, Pricing Policies and Caps

2.3.1 *Purchases of crude oil and other raw materials, auxiliary materials, power and fuel and corresponding services*

Background: The Company produces products including petroleum products, intermediate petrochemical products and other petroleum refined by-products. All of these products are produced from processing of crude oil, other raw materials, and auxiliary materials. Since the Company's initial public offer on 15 November 1994, the Company has been purchasing crude oil, other raw materials and auxiliary materials from Sinopec Corp and its associates, including Sinopec Pipeline Transport & Storage Company (a branch of Sinopec Corp), China International United Petroleum & Chemicals Co., Ltd (a subsidiary of Sinopec Corp) and Sinopec Shengli Oilfield Co., Ltd. (a subsidiary of Sinopec Corp). Other raw materials include methanol, naphtha, methyl tertiary-butyl ether and residue; auxiliary materials include catalysts.

LETTER FROM THE CHAIRMAN

The table below sets forth the historical figures of the Company's aggregate purchases of raw materials from Sinopec Corp and its associates for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002	2003	2004
	<i>(RMB million)</i>	<i>(RMB million)</i>	<i>(RMB million)</i>
Import of crude oil	3,861	6,163	14,853
Purchase of domestically-produced crude oil	1,874	2,102	—
Import and export of crude oil service charges	<u>30</u>	<u>46</u>	<u>75</u>
	<u><u>5,765</u></u>	<u><u>8,311</u></u>	<u><u>14,928</u></u>

Source: Annual reports of the Company for 2003 and 2004.

The Company entered into the Mutual Supply Framework Agreement to continue to purchase crude oil and other raw materials, auxiliary materials, power and fuel and corresponding services from Sinopec Corp and its associates for the three years ending 31 December 2007.

Reasons for such transactions: China's oil and petrochemical industry has always been the subject of extensive regulation by the PRC government. Transactions involving crude oil are subject to State allocation. In accordance with the State plan, the Company's imported crude oil is allocated by Sinopec Corp, and the Company imports crude oil through the associates of Sinopec Corp. The Company also purchases domestically-produced crude oil from the associates of Sinopec Corp. Accordingly, the Company's allocation of raw material requirements are governed by State regulations and administrative measures of Sinopec Corp.

Pricing: Pursuant to the Mutual Supply Framework Agreement, the price of the crude oil related raw materials purchased from Sinopec Corp and its associates are determined as follows:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the Company's purchases shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the Company's purchases shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the pricing of the Company's purchases shall be determined in accordance with the prevailing market price (including any bidding price).

The Company will settle the purchases of crude oil and other raw materials, auxiliary materials, power and fuel and corresponding services by way of cash payments.

LETTER FROM THE CHAIRMAN

Caps: For the three years ending 31 December 2007, the annual transaction values in relation to the purchases of crude oil and other raw materials, auxiliary materials, power and fuel and corresponding services from Sinopec Corp and its associates shall not, in aggregate, exceed the Caps of RMB37,619 million (equivalent to HK\$36,144 million), RMB55,192 million (equivalent to HK\$53,028 million) and RMB78,965 million (equivalent to HK\$75,869 million), respectively.

The Caps referred to above are determined with reference to:

- (a) the previous transactions conducted and transaction amounts in respect of purchases of raw materials from Sinopec Corp and its associates. For the three years ended 31 December 2004, purchase of raw materials by the Company from Sinopec Corp and its associates increased by a compound annual growth rate of 61%;
- (b) the Company's estimate of its business growth;
- (c) the Company's estimate of the increase in its production capacity; and
- (d) the Company's estimate of the increase in the costs of raw materials.

The Company's principal raw material is crude oil. In recent years, prices of crude oil have been fluctuating widely. The average dated price (freight-on-board) of Brent crude oil increased by 15.5% in 2003 as compared to that of the previous year, by 32.7% in 2004 as compared to that of the previous year and by 47% in the first half of 2005 as compared to that of the same period of the previous year. The Company has taken into account the increasing crude oil price in determining the Caps for the years ending 2005, 2006 and 2007.

Additionally, in 2004 the Company's comprehensive processing capacity was 16 million tpa. Since 2004, the Company has commenced the 20 million tpa refining capacity expansion project. In April 2005, the Company completed the construction and commenced operation of a 1 million tpa delayed coking unit, which led to an increase in comprehensive processing capacity to 18.5 million tpa. It is expected that by the end of 2006, the Company will complete construction and commence operation of a 1.5 million tpa hydrocracking unit and related auxiliary facilities, and will increase its comprehensive processing capacity to 20 million tpa. The completion of the new projects will significantly increase the production capacity of the Company, which also gives rise to an increase in the need for crude oil and other raw materials. Taking into account these factors, the Company arrives at the Caps above.

2.3.2 Revenue from Petroleum Products Sales and Service Provision

Background: The products sold by the Company include refined products (such as gasoline, diesel, kerosene, naphtha, heavy fuel, solvent oil, clean oil and raw materials for clean oil), intermediate petrochemical products (such as benzene, PX, propylene and polypropylene) and other petroleum refined by-products (such as asphalt, petroleum coke and sulphur). Transactions involving sales and purchases of refined products (including gasoline, diesel and kerosene) are subject to regulation by the PRC government. Since the Company's initial public offer on 15 November 1994, the Company has been selling products and providing corresponding services in accordance with the State's requirement to Sinopec Corp and its associates. The Company convened extraordinary general

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meetings in December 2003 and February 2005 respectively which approved the connected transaction in relation to sales of PX entered into between the Company and Yizheng (a subsidiary of Sinopec Corp) and the connected transactions in relation to the sale of naphtha entered into between the Company and SECCO (an associate of Sinopec Corp). Further details of the connected transactions in relation to sales of PX and naphtha are contained in the Company's circulars dated 2 December 2003 and 24 December 2004, respectively. The Company's connected transaction with regards to PX with Yizheng will expire on 31 December 2005, and the connected transactions with regards to naphtha with SECCO will expire on 31 December 2007. Upon approval by the Independent Shareholders of the Mutual Supply Framework Agreement, the agreement entered into between the Company and Yizheng on 10 November 2003 in respect of PX will lapse and will be replaced by the Mutual Supply Framework Agreement. The agreement entered into between the Company and SECCO in respect of naphtha on 7 December 2004 will continue to be effective.

Sinopec Corp was one of the Company's five largest customers for the three years ended 31 December 2004. The table below sets forth the historical figures of the Company's aggregate sales of products and revenue from service provision to Sinopec Corp and its associates for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002	2003	2004
	<i>(RMB million)</i>	<i>(RMB million)</i>	<i>(RMB million)</i>
Sales of PX to Yizheng	0	293	1,771
Sales of other products and provision of services to Sinopec Corp and its associates	<u>14,575</u>	<u>21,072</u>	<u>30,353</u>
	<u>14,575</u>	<u>21,365</u>	<u>32,124</u>

Source: Annual reports of the Company for 2003 and 2004.

The Company entered into the Mutual Supply Framework Agreement to continue to sell products and provide corresponding services to Sinopec Corp and its associates for the three years ending 31 December 2007.

Reasons for such transactions: China's oil and petrochemical industry has always been the subject of extensive regulation by the PRC government. Transactions involving the sale and purchase of petroleum products are controlled by the PRC government. Accordingly, the Company's sales of petroleum products are governed by the relevant PRC regulations and measures. These regulations and measures dictate the transaction value, the volume and all other terms and conditions at which the Company conducts its sales of petroleum products. Most of the end users of intermediate petrochemical products are Sinopec Corp and its associates, and selling to large customers can ensure stable sales.

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Pricing: The selling prices of products and services to Sinopec Corp and its associates under the Mutual Supply Framework Agreement are determined as follows:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the Company's sales shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the Company's sales shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the pricing of the Company's sales shall be determined in accordance with the prevailing market price (including any bidding price).

Sinopec Corp and its associates will settle their purchases of the Company's petroleum products and related services by way of cash payments.

Caps: For the three years ending 31 December 2007, the annual transaction values in relation to the revenue of products sales and services provision to Sinopec Corp and its associates shall not, in aggregate, exceed the Caps of RMB53,973 million (equivalent to HK\$51,857 million), RMB74,622 million (equivalent to HK\$71,696 million) and RMB102,155 million (equivalent to HK\$98,150 million), respectively.

The Caps referred to above are determined with reference to:

- (a) the previous transactions conducted and transaction amounts in respect of sales of products and provision of services to Sinopec Corp and its associates (including Yizheng). For the three years ended 31 December 2004, sales of products and provision of services to Sinopec Corp and its associates increased by a compound annual growth rate of 48%;
- (b) the Company's estimate of the increase in the costs of raw materials;
- (c) the Company's estimate of the increase in the overall demand for petroleum products in the PRC; and
- (d) the Company's estimate of the increase in the market price of petroleum products and the market price of services. In general, market price of petroleum products increases as raw material price, in particular crude oil price, increases.

Additionally, in 2004 the Company's comprehensive processing capacity was 16 million tpa. Since 2004, the Company has commenced the 20 million tpa refining capacity expansion project. In April 2005, the Company completed the construction and commenced operation of a 1 million tpa delayed coking unit, which led to an increase in comprehensive processing capacity to 18.5 million tpa. It is expected that by the end of 2006, the Company will complete construction and commence operation of a 1.5 million tpa hydrocracking unit and related auxiliary facilities, and will increase its comprehensive processing capacity to 20 million tpa. The completion of the new projects will significantly increase the production capacity of the Company. Accordingly, the Company expects that its sales would increase as a result of an enlarged production capacity. Taking into account these factors, the Company arrives at the Caps above.

LETTER FROM THE CHAIRMAN

2.3.3 Agency Sales of Petrochemical Products

Background: Currently, the Company sells its petrochemical products primarily by its sales personnel. The Company entered into the Mutual Supply Framework Agreement to appoint Sinopec Corp and its associates as agents of the Company in respect of the agency sales of the Company's petrochemical products for the three years ending 31 December 2007.

Reasons for such transactions: Trading, distribution and marketing of the Company's products are important elements in the success of the business of the Company. The Company considers the broadening of its trading, distribution and marketing network to be beneficial.

Sinopec Corp is one of the largest petrochemical companies in Asia and has a strong trading, distribution and marketing network. The Company believes that it will benefit from Sinopec Corp's experience, expertise and strong global network and will increase the sales of its petrochemical products and improve the Company's bargaining position with customers.

Pricing: Pursuant to the Mutual Supply Framework Agreement, the commissions payable to Sinopec Corp and its associates in connection with the agency sales of the Company's petrochemical products are determined on the prevailing market percentage commission of the agency sales of the Company's petrochemical products.

The Company will settle the agency commissions by way of cash payments.

Caps: For the three years ending 31 December 2007, the annual commission payable to Sinopec Corp and its associates for the agency sales of the Company's petrochemical products shall not, in aggregate, exceed the Caps of RMB74 million (equivalent to HK\$71 million), RMB153 million (equivalent to HK\$147 million) and RMB192 million (equivalent to HK\$184 million), respectively.

The Caps referred to above are determined with reference to:

- (a) the sales amounts of the Company's of petrochemical products in the past. For the three years ended 31 December 2004, the sales of the Company's petrochemical products amounted to RMB1,947 million, RMB3,068 million and RMB6,339 million, respectively;
- (b) the Company's estimate of the increase in the overall demand for petrochemical products in the PRC;
- (c) the Company's estimate of its business growth; and
- (d) the Company's estimate of the prevailing market percentage commission of the agency sales of petrochemical products.

Additionally, in 2004 the Company's comprehensive processing capacity was 16 million tpa. Since 2004, the Company has commenced the 20 million tpa refining capacity expansion project. In April 2005, the Company completed the construction and commenced operation of a 1 million tpa delayed coking unit, which led to an increase

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in comprehensive processing capacity to 18.5 million tpa. It is expected that by the end of 2006, the Company will complete construction and commence operation of a 1.5 million tpa hydrocracking unit and related auxiliary facilities, and will increase its comprehensive processing capacity to 20 million tpa. The completion of the new projects will significantly increase the production capacity of the Company. Accordingly, the Company expects its sales through its agents will increase as a result of the Company's enlarged production capacity.

As such, the Company expects that the commissions payable to Sinopec Corp and its associates in relation to agency sales of the Company's petrochemical products will increase in 2005, 2006 and 2007. Taking into account these factors, the Company arrives at the Caps above.

2.3.4 Construction and Overhaul of Production or Other Facilities Services

Background: Since the Company's initial public offer on 15 November 1994, the Company has from time to time obtained in the ordinary and usual course construction and overhaul services from Sinopec Group Company and its associates, in order to construct and overhaul its production or other facilities. The construction and overhaul also requires the purchase of equipment from Sinopec Group Company and its associates. The table below sets forth the historical figures of the total construction and overhaul fees the Company paid to Sinopec Group Company's associates for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002	2003	2004
	<i>(RMB million)</i>	<i>(RMB million)</i>	<i>(RMB million)</i>
Construction fee expenses	167	347	384
Purchase of equipment and related service fee charge	<u>216</u>	<u>831</u>	<u>404</u>
	<u><u>383</u></u>	<u><u>1,178</u></u>	<u><u>788</u></u>

Source: Annual reports of the Company for 2003 and 2004.

The Company entered into the Comprehensive Services Framework Agreement to continue to obtain construction and overhaul services (including equipment purchase and related services) from Sinopec Group Company and its associates for the three years ending 31 December 2007.

Reasons for such transactions: Major specialist teams on petrochemical construction and overhaul services are concentrated in Sinopec Group Company and its associates. Using these teams allows the Company to obtain stable, reliable and high-quality services for its construction and overhaul of production and other facilities.

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By purchasing equipment through the associates of Sinopec Group Company, the Company can share their professional service network and obtain a better bargaining position through group purchase. The Company believes that this will ensure the Company to obtain reliable equipment purchase and related services at stable prices, whereby reducing the total cost of constructing and overhauling production or other facilities.

Pricing: Pursuant to the Comprehensive Services Framework Agreement, the fees payable to Sinopec Group Company and its associates in relation to the provision of construction and overhaul services (including equipment purchase) are priced as follows:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the construction and overhaul shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the construction and overhaul shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the pricing of construction and overhaul shall be determined in accordance with the prevailing market price (including any bidding price); or
- (d) if none of the above applies, the Company's construction and overhaul pricing shall be determined on a cost plus basis. The margin shall be fixed at a rate not exceeding 6%.

The Company will settle the service fees by way of cash payments.

Caps: For the three years ending 31 December 2007, the annual fees payable to Sinopec Group Company and its associates in relation to the provision of construction and overhaul services (including equipment purchase) shall not, in aggregate, exceed the Caps of RMB3,100 million (equivalent to HK\$2,978 million), RMB12,170 million (equivalent to HK\$11,693 million) and RMB13,434 million (equivalent to HK\$12,907 million), respectively.

The Caps referred to above are determined with reference to:

- (a) the previous transactions conducted and transaction amounts in respect of provision of construction and overhaul services by Sinopec Group Company and its associates;
- (b) the Company's estimate of the need of construction and overhaul services for the Company's existing and future development; and
- (c) the Company's estimate of the increase in the market price of construction and overhaul services.

Contracts on major construction projects for the 2005–2007 period include: (a) the Company will invest from 2005 to 2007 a sum of RMB4.1 billion to complete the 20 million tpa refinery capacity expansion project; (b) from 2005 onwards, the Company will commence the 1 million tpa ethylene project with a total investment estimated at RMB21.5 billion; and (c) the major overhaul in 2006 and scattered maintenance projects to be carried annually is estimated to have annual transaction values of approximately RMB500 million. In light of the possibility of a certain degree of increase in equipment

LETTER FROM THE CHAIRMAN

and material prices when actual investment takes place, and in light of the possibility that certain projects may be carried out earlier or later than the schedule due to adjustments made to the actual investment in each year in accordance with market situation and project progress, the Caps for 2006 and 2007 are determined by allowing a 10% rise on the estimated total investment for each of the years 2006 and 2007, plus of 20% of the Caps for the previous year in the Caps for the following year.

	2005 <i>(RMB million)</i>	2006 <i>(RMB million)</i>	2007 <i>(RMB million)</i>
20 million tpa refining capacity expansion project	1,600	1,500	1,000
1 million tpa ethylene project	1,000	8,500	8,500
Overhaul	<u>500</u>	<u>500</u>	<u>500</u>
Total for the year	<u><u>3,100</u></u>	<u><u>10,500</u></u>	<u><u>10,000</u></u>
Caps on the construction and overhaul services	3,100	12,170	13,434

2.3.5 Financial Services

Background: As mentioned above, the Company sells petroleum products to Sinopec Corp and its associates. Sinopec Corp and its associates make payment to the Company through Sinopec Finance Company Limited at which the Company has opened a settlement account. The Company earns interest on the outstanding balance of the settlement account prior to the funds being transferred to Company's accounts opened with commercial banks. Sinopec Finance Company Limited is a non-bank finance company approved and regulated by the People's Bank of China ("PBOC") and the China Banking Regulatory Commission ("CBRC"), and is an associate of Sinopec Group Company.

The table below sets forth the historical figures of the aggregate balance of the Company's settlement account with Sinopec Finance Company and net interest income for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002 <i>(RMB million)</i>	2003 <i>(RMB million)</i>	2004 <i>(RMB million)</i>
Settlement account balance	419	669	1,627
Net interest income	1	0.7	1.5

Source: Annual reports of the Company for 2003 and 2004.

The settlement account balance should not be treated deposits with Sinopec Finance Company as they are proceeds from sales to Sinopec Corp and its associates and such proceeds normally stay in the settlement account for a couple of days before they are remitted to the Company's other bank accounts.

LETTER FROM THE CHAIRMAN

To better manage its cashflow position, the Company entered into the Comprehensive Services Framework Agreement to obtain the following financial services from Sinopec Finance Company for the three years ending 31 December 2007:

- payment collection services: the Company will use Sinopec Finance Company for collecting and making payments
- deposit account and related interest income: the Company will open a deposit account to replace the settlement account with Sinopec Finance Company
- loan services: the Company may borrow money from Sinopec Finance Company in time of capital shortage. Loans will be granted by Sinopec Finance Company on normal commercial terms and on an unsecured basis to the Company. As such, pursuant to rule 14A.65(4) of the Listing Rules, such loans will be considered to be financial assistance, exempt from reporting, announcement and Independent Shareholders' approval requirements.

Reasons for such transactions: The Company believes that having reliable and cooperative financial services are important to its business as the nature of the Company's business means that transactions often involve large sums of money. The ability to obtain timely financial services in respect of collecting and making payments, deposit and loan facilities is essential to the Company's management of its cashflow requirements, allowing the Company to earn higher return on excess cash and obtain necessary financial resources in time of capital shortage.

Pricing: Pursuant to the Comprehensive Services Framework Agreement, (i) the collection and payment services will be provided by Sinopec Finance Company free of charge; and (ii) Sinopec Finance Company shall accept deposits from the Company at interest rates not lower, and thus no less favourable, than the relevant standard rates set by the PBOC for similar deposits.

Sinopec Finance Company will settle the deposit balance and interest income by way of cash payments.

Caps: For the three years ending 31 December 2007, the maximum of the deposit account (including related interest income) during the year with Sinopec Finance Company shall not, in aggregate, exceed the Caps of RMB1,752 million (equivalent to HK\$1,683 million), RMB1,902 million (equivalent to HK\$1,827 million) and RMB1,952 million (equivalent to HK\$1,875 million), respectively.

The Caps in respect of deposit services referred to above are determined with reference to:

- (a) the previous balances of the settlement account with Sinopec Finance Company Limited;
- (b) the Company's estimate of its business growth; and
- (c) the volume of the Company's sale with Sinopec Corp and its associates.

LETTER FROM THE CHAIRMAN

2.3.6 Insurance Services

Background: Since the Company's initial public offer on 15 November 1994, the Company has been, in the ordinary and usual course of its business, maintaining with a subsidiary of Sinopec Group Company insurance coverage for its property, facilities and inventory pursuant to the administrative measures of Sinopec Group Company. The funds received for security and protection measures from Sinopec Group Company were aimed at strengthening the security and protection measures or carrying out specific research projects.

The table below sets forth the historical figures of the aggregate insurance premium the Company paid to Sinopec Group Company and the funds received for security and protection measures for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002	2003	2004
	<i>(RMB million)</i>	<i>(RMB million)</i>	<i>(RMB million)</i>
Insurance premium expenses	41	45	54
Safety funds received	19	18	17

Source: Annual reports of the Company for 2003 and 2004.

The Company entered into the Comprehensive Services Framework Agreement to continue to obtain insurance services from Sinopec Group Company and its associates for the three years ending 31 December 2007.

Reasons for such transactions: Captive insurance has been widely adopted in the petrochemical industry. The Ministry of Finance of the PRC has already granted approval for Sinopec Group Company to provide captive insurance services to its affiliates. Owing to the size of the Company's operation, the Company finds it difficult to identify suitable insurance firms to provide insurance coverage for its property, facilities and inventory at a reasonable insurance premium in the PRC. The Company believes that maintaining a suitable insurance coverage over the Company's operation is important and minimises the Company's risk exposure. Obtaining insurance services from Sinopec Group Company allows the Company to secure essential insurance coverage over the Company's operation and is therefore beneficial to the Company.

Pricing: Pursuant to the Comprehensive Services Framework Agreement, the premium payable to Sinopec Group Company and its associates in relation to the provision of insurance services is priced as follows:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the premium shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the premium shall be bound by the State guided prices; or

LETTER FROM THE CHAIRMAN

- (c) if there are no applicable State tariffs or State guided prices, the pricing of the premium shall be determined in accordance with the prevailing market price (including any bidding price); or
- (d) if none of the above applies, the premium shall be determined on a cost plus basis. A reasonable margin shall be fixed in accordance with the actual situation at the time of transaction.

The Company will pay the premium by way of cash payments.

Caps: For the three years ending 31 December 2007, the annual insurance premium payable to Sinopec Group Company and its associates shall not, in aggregate, exceed the Caps of RMB56 million (equivalent to HK\$54 million), RMB66 million (equivalent to HK\$63 million) and RMB83 million (equivalent to HK\$80 million), respectively. For the three years ending 31 December 2007, the annual safety funds received from Sinopec Group and its associates will not exceed RMB20 million (equivalent to HK\$19 million), RMB25 million (equivalent to HK\$24 million) and RMB33 million (equivalent to HK\$32 million).

The Caps referred to above are determined with reference to:

- (a) the previous transactions conducted and transaction amounts in respect of provision of insurance services by Sinopec Group Company and its associates;
- (b) the Company's estimate of the growth in the value of its facilities in view of the Company's existing and future development;
- (c) the increase in the risk exposure of the Company; and
- (d) the Company's estimate of the increase in the market price of insurance services.

Additionally, in 2004 the Company's comprehensive processing capacity was 16 million tpa. Since 2004, the Company has commenced the 20 million tpa refining capacity expansion project. In April 2005, the Company completed the construction and commenced operation of a 1 million tpa delayed coking unit, which led to an increase in the comprehensive processing capacity to 18.5 million tpa. It is expected that by the end of 2006, the Company will complete construction and commence operation of a 1.5 million tpa hydrocracking unit and related auxiliary facilities, and will increase its comprehensive processing capacity to 20 million tpa. Apart from the aforesaid refining projects, the Company will, from 2005 onwards, commence the 1 million tpa ethylene project; the ethylene properties and facilities will be covered by insurance. Accordingly, the Company expects its insurance premium for 2005, 2006 and 2007 will increase, so that sufficient insurance coverage is ensured for these new facilities.

2.3.7 Research and Development Services

Background: The Company, pursuant to the administrative measures applicable to all the companies under Sinopec Corp, participates in the research and development projects of Sinopec Corp. Since the Company's initial public offer on 15 November 1994, Sinopec Corp and its associates have been providing corresponding research and technical services to the Company's research and development. Meanwhile, the Company has been

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undertaking certain research and development projects of Sinopec Corp. In 2004, the Company, pursuant to Sinopec Corp's administrative measures, undertook research and development projects on its own. Accordingly, no paid or payable research and development fees to Sinopec Corp and its associates had incurred. However, the construction of the 1 million tpa ethylene project may require the Company to obtain research and development support from Sinopec Group Company and its associates. Research and development funds had been received from Sinopec Corp for carrying out research and development projects with extensive application value for refineries under Sinopec Corp.

The table below sets forth the historical figures of the aggregate research and development fees the Company paid to Sinopec Corp and its associates and research and development subventions received from Sinopec Corp for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002	2003	2004
	<i>(RMB million)</i>	<i>(RMB million)</i>	<i>(RMB million)</i>
Research and development fees	35	35	0
Research and development subventions received	5	8	0

Source: Annual reports of the Company for 2003 and 2004.

The Company entered into the Comprehensive Services Framework Agreement to continue to obtain research and development services from Sinopec Group Company, Sinopec Corp and their associates for the three years ending 31 December 2007.

Reasons for such transactions: Sinopec Corp and its associates as well as Sinopec Group Company have strong research and development capability in the industry. The Company has, since its initial public offer, been obtaining services from that institution. The transaction entered into helps promote the Company's technical advancement and product development.

Pricing: Pursuant to the Comprehensive Services Framework Agreement, the research and development fees payable to Sinopec Corp and its associates in relation to the provision of the research and development services are priced as follows:

- (a) if there are applicable State (central and local governments) tariffs, the research and development fees shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the research and development fees shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the research and development fees shall be determined in accordance with the prevailing market price (including any bidding price); or

LETTER FROM THE CHAIRMAN

- (d) if none of the above applies, the research and development fees shall be determined on a cost plus basis.

The Company will settle the research and development fees by way of cash payments.

Caps: For the three years ending 31 December 2007, the annual research and development fees payable to Sinopec Corp and its associates in relation to the provision of research and development services shall not, in aggregate, exceed the Caps of RMB35 million (equivalent to HK\$34 million), RMB35 million (equivalent to HK\$34 million) and RMB35 million (equivalent to HK\$34 million), respectively. The annual research and development subventions received from Sinopec Corp and its associates shall not, in aggregate, exceed the Caps of RMB10 million (equivalent to HK\$10 million), RMB12 million (equivalent to HK\$12 million) and RMB18 million (equivalent to HK\$17 million), respectively.

The Caps referred to above are determined with reference to:

- (a) the previous transactions conducted and transaction amounts in respect of the provision of research and development services by Sinopec Corp and its associates;
- (b) the Company's estimate of the need of research and development for its existing and future development;
- (c) the Company's estimate of the increase in the market price of research and development services.

2.3.8 *Land Management and Leasing Services*

Background: Sinopec Group Company, in a letter of undertaking to the Company, has granted the Company the first refusal right to purchase a piece of land, located adjacent to the Company and with an area of approximately 9.51 million square metres, for the Company's future expansion. Should the Company purchase the land from Sinopec Group Company in the future, it will constitute a connected transaction and will be subject to the regulations on connected transactions as stipulated in Chapter 14 of the Listing Rules. The Company currently leases the land for its operation. The waiver the Company obtained at the time of its initial public offer on 15 November 1994 does not include land management and leasing services. According to Rule 14.07 of the Listing Rules, in 2004 the relevant applicable ratios were below 0.1% for the land management and leasing services which constituted a Continuous Connected Transaction exempted from the requirements for reporting, announcement and approval of Independent Shareholders.

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The table below sets forth the historical figures of the land management and leasing fees paid to Sinopec Group Company for each of the three years ended 31 December 2004:

	Historical Figures for the year ended 31 December		
	2002	2003	2004
	<i>(RMB million)</i>	<i>(RMB million)</i>	<i>(RMB million)</i>
Operating lease expense in respect of land	0	0	13

Source: Annual reports of the Company for 2003 and 2004.

The Company entered into the Comprehensive Services Framework Agreement to continue to obtain the land management and leasing services from Sinopec Group Company and its associates for the three years ending 31 December 2007.

Reasons for such transactions: Sinopec Group Company owns the land lot, which is adjacent to the Company and occupies an area of approximately 9.51 million square metres. The transaction allows the Company to use the site for construction usage at a relatively low cost.

Pricing: Pursuant to the Comprehensive Services Framework Agreement, the land management and leasing service fees payable to Sinopec Group Company and its associates are priced as follows:

- (a) if there are applicable State (central and local governments) tariffs, the land management and leasing fees shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the land management and leasing fees shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the land management and leasing fees shall be determined in accordance with the prevailing market price (including any bidding price).

The Company will settle the service fees by way of cash payments.

Caps: For the three years ending 31 December 2007, the annual fees for land management and leasing services payable to Sinopec Group Company and its associates shall not, in aggregate, exceed the Caps of RMB15 million (equivalent to HK\$14 million), RMB29 million (equivalent to HK\$28 million) and RMB36 million (equivalent to HK\$35 million), respectively.

The Caps referred to above are determined with reference to:

- (a) the previous transactions conducted and transaction amounts in respect of the provision of land management and leasing services provided by Sinopec Group Company and its associates;

LETTER FROM THE CHAIRMAN

- (b) the Company's estimate of the need of land management and leasing services for its existing and future development;
- (c) the Company's estimate of the increase in the market price of land management and leasing services.

3. BOARD APPROVAL

On 19 August 2005, the Board approved each of the Continuing Connected Transactions and the execution of the Framework Agreements.

The Board takes the view that the terms of the Continuing Connected Transactions and the Framework Agreements are fair and reasonable, on normal commercial terms and are entered into in the usual and ordinary course of business and that the Continuing Connected Transactions and the Framework Agreements are in the interests of the Company and its Shareholders as a whole.

4. GENERAL

The Company is an integrated refining and chemical enterprise, processing crude oil into petroleum products, intermediate petrochemical products, asphalt, urea and petrochemical products such as PX and polypropylene.

Sinopec Corp holds 1,800,000,000 state-owned legal person shares in the Company, representing 71.32% of the issued share capital of the Company. Sinopec Corp, as a controller of the Company, is a connected person of the Company.

The Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) are subject to the approval of the Independent Shareholders at the EGM by way of poll. An Independent Board Committee has been set up to advise the Independent Shareholders on the terms of the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps). The Company has appointed Partners Capital as the independent financial adviser to the Independent Board Committee and Independent Shareholders in this regard.

Ordinary resolution to approve the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) will be proposed at the EGM. **Sinopec Corp and its associates (as defined under the Listing Rules) will abstain from voting in respect of the ordinary resolution to be proposed at the EGM.**

The procedures for demanding a poll are set out in Appendix II to this circular. The Company will announce the results of the poll in accordance with the Listing Rules following the EGM.

The Company will seek the approval by the Independent Shareholders of the Framework Agreements and the Non-Exempt Continuing Connected Transactions including the Caps for the three financial years ending 31 December 2007 subject to the following conditions:

1. The Non-Exempt Continuing Connected Transactions will be:
 - (i) entered into by the Company in the ordinary and usual course of its business;

LETTER FROM THE CHAIRMAN

- (ii) conducted on normal commercial terms or, if there are no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available from independent third parties; and
 - (iii) entered into in accordance with the terms of the Framework Agreements governing such Non-Exempt Continuing Connected Transactions that are fair and reasonable and in the interests of the shareholders of the Company as a whole;
2. The respective transacted amount of the transactions under the Framework Agreements for the three years ending 31 December 2007 shall not exceed the respective Cap;
 3. The Company will comply with all other relevant requirements under the Listing Rules.

5. RECOMMENDATION

Your attention is drawn to the letter from the Independent Board Committee which is set out on page 25 of this circular. The Independent Board Committee, having taken into account the advice of Partners Capital, considers that the terms of the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) are fair and reasonable and the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) are 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 ordinary resolution to be proposed at the EGM.

6. FURTHER INFORMATION

Your attention is also drawn to the additional information set out in the Appendices to this circular.

Yours faithfully,
By Order of the Board
Sun Weijun
Chairman



中國石化鎮海煉油化工有限公司
SINOPEC ZHENHAI REFINING & CHEMICAL COMPANY LIMITED

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

(Stock Code: 1128)

16 September 2005

To the Independent Shareholders

Dear Sir or Madam,

We refer to the circular (the “Circular”) dated 16 September 2005 despatched to the Shareholders of which this letter forms part. Unless the context requires otherwise, terms and expressions defined in the Circular shall have the same meanings in this letter.

We have been appointed to advise the Independent Shareholders on whether the terms of the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) are fair and reasonable and in the interests of the Company and the Shareholders as a whole. Partners Capital has been appointed to advise the Independent Board Committee and Independent Shareholders in respect of the terms of the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps).

We wish to draw your attention to the letter from the Chairman set out on pages 5 to 24 of the Circular and the letter from Partners Capital set out on pages 26 to 40 of the Circular.

Having considered the advice given by Partners Capital, we are of the opinion that the terms of the Framework Agreements and the Non-Exempt Continuing Connected Transactions (including their Caps) are fair and reasonable, and the Framework Agreements as well as the Non-Exempt Continuing Connected Transactions (including their Caps) are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM.

Yours faithfully,

For and on behalf of the Independent Board Committee

Sun Yongsen

Independent Non-executive Director

Cen Kefa

Independent Non-executive Director

Li Linghong

Independent Non-executive Director

Qiu Yun

Independent Non-executive Director

LETTER FROM PARTNERS CAPITAL

Set out below is a letter from Partners Capital for the purpose of inclusion into this circular.



博大資本國際有限公司

Partners Capital International Limited

Partners Capital International Limited
Room 1305, 13th Floor
9 Queen's Road Central
Hong Kong

16 September 2005

*To the Independent Board Committee and the Independent Shareholders of
Sinopec Zhenhai Refining & Chemical Company Limited*

Dear Sirs,

NON-EXEMPT CONTINUING CONNECTED TRANSACTIONS

INTRODUCTION

We refer to our engagement to advise the Independent Board Committee in respect of the terms of the Framework Agreements and the Non-Exempt Continuing Connected Transactions contemplated thereunder (including the Caps), particulars of which are set out in a circular (the "Circular") to the Shareholders dated 16 September 2005 and in which this letter is reproduced. Unless the context requires otherwise, terms used in this letter shall have the same meanings as given to them under the definitions section of the Circular.

As set out in the letter from the Chairman (the "Letter from the Chairman") contained in the Circular, the Company entered into the Framework Agreements with Sinopec Corp and Sinopec Group Company respectively on 19 August 2005 in relation to the finalisation of the general terms of the Non-Exempt Continuing Connected Transaction. Sinopec Corp is the holding company of the Company and Sinopec Group Company is the holding company of Sinopec Corp and the ultimate parent company of the Company. Sinopec Corp and Sinopec Group Company are therefore connected persons of the Company under the Listing Rules. As the respective amounts of the Non-Exempt Continuing Connected Transactions (namely the purchase of raw materials, sales of products and services, construction and overhaul services and financial services as set out in the paragraph headed "Background of and reasons for the Non-Exempt Continuing Connected Transactions") exceed HK\$10 million and the relevant applicable ratios under Rule 14.07 of the Listing Rules exceed 2.5% whilst the agency sales of products, whose relevant applicable ratio exceed 0.1% but less than 2.5%, are also considered as non-exempt Continuing Connected Transactions as they are aggregated in the same category of sales of products and services, certain continuing connected transactions under the respective Framework Agreement entered into between the Company, Sinopec Corp and Sinopec Group Company constitute non-exempt continuing connected transactions pursuant to the Listing Rules and the Non-Exempt Continuing Connected Transactions are subject to reporting, announcement, and the Independent Shareholders' approval requirements under the Listing Rules. As such, the EGM will be held for the purpose of obtaining the approval from the Independent Shareholders for the Framework Agreements, the Non-Exempt Continuing Connected Transactions and the Caps by way of poll. Sinopec Corp and their associates and any other connected persons (as defined under the Listing Rules) will abstain from voting in respect of the ordinary resolution to be proposed at the EGM.

LETTER FROM PARTNERS CAPITAL

Partners Capital International Limited is not connected with the directors, chief executive and substantial shareholders of the Company or any of their subsidiaries or their respective associates and therefore is considered suitable to give independent advice to the Independent Board Committee. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby Partners Capital International Limited will receive any fees or benefits from the Company, the directors, chief executive or substantial shareholders of the Company or any of their subsidiaries or their respective associates.

In formulating our opinion, we have relied on the accuracy of the information and representations contained in the Circular and have assumed that all information and representations made or referred to in the Circular as provided by the Directors were true at the time they were made and continue to be true as at the date of the Circular. We have also relied on our discussion with the Directors regarding the information and representations contained in the Circular. We have also assumed that all statements of belief, opinion and intention made by the Directors in the Circular were reasonably made after due enquiry. We consider that we have reviewed sufficient information to reach an informed view, to justify relying on the accuracy of the information contained in the Circular and to provide a reasonable basis for our advice. We have no reason to suspect that any material facts have been omitted or withheld from the information contained or opinions expressed in the Circular nor to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors. We have not, however, conducted an independent in-depth investigation into the business and affairs of the Group, Sinopec Corp, Sinopec Group Company and their respective associates nor have we carried out any independent verification of the information supplied.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion regarding the terms of the Non-Exempt Continuing Connected Transactions (including the Caps), we have considered the following principal factors and reasons:

(i) **Background of and reasons for the Non-Exempt Continuing Connected Transactions**

A. *Overview*

The Company is principally engaged in the production and sale of petroleum products (including gasoline, diesel, kerosene, naphtha, liquefied petroleum gas, solvent oil and fuel oil), intermediate petrochemical products, asphalt, urea and other petrochemical products (including paraxylene and polypropylene). Gasoline, diesel and kerosene are three major products of the Company.

As set out in the Letter from the Chairman, the Company had been conducting certain continuing connected transactions with Sinopec Corp and Sinopec Group Company and their associates (as the case may be) and the Company was granted waivers from strict compliance with the relevant provisions of the Listing Rules by the Hong Kong Stock Exchange with respect to certain Continuing Connected Transactions with Sinopec Group Company and its associates at the time of the Company's initial public offering on 15 November 1994. These transactions included purchases of domestic crude oil and other raw materials, import of crude oil, sales of refined products or by-products, research and development arrangements, insurance arrangements and carrying out of construction and overhaul of production and other facilities. The Hong Kong Stock Exchange subsequently confirmed prior to February 2000 when Sinopec Group Company, formerly a substantial shareholder having a direct interest in the Company, underwent a major reorganisation to establish Sinopec Corp, that these waivers would remain valid following such

LETTER FROM PARTNERS CAPITAL

reorganisation. As a result of recent changes to the Listing Rules, these waivers are no longer valid and the Company must now comply with the relevant Listing Rules requirements for it to continue conducting the Continuing Connected Transactions previously subject to waivers. In addition, the Company proposes to enter other Continuing Connected Transactions in respect of the agency sales of products, financial services and land management and leasing with Sinopec Corp and Sinopec Group Company. In view of the aforesaid, the Company entered into the Mutual Supply Framework Agreement with Sinopec Corp and Comprehensive Services Framework Agreement with Sinopec Group Company. The relevant transactions under the Mutual Supply Framework Agreement and the Comprehensive Services Framework Agreement are as follows:

- *Mutual Supply Framework Agreement*

As mentioned in the Letter from the Chairman, the transactions under the Mutual Supply Servicing Framework Agreement include the following transactions:

- A. Purchases of raw materials including crude oil, methanol, naphtha, methyl tertiary-butyl ether and residue; auxiliary materials including catalysts, and other intermediate petrochemical raw materials and coal;
- B. Sales of refined products (such as gasoline, diesel, kerosene, naphtha, heavy fuel, solvent oil, clean oil and raw materials for clean oil), intermediate petrochemical products (such as benzene, PX, propylene and polypropylene) and other petroleum refined by-products (such as asphalt, petroleum coke and sulphur); and
- C. Agency sales of petrochemical products produced by the Company to customers);

- *Comprehensive Services Framework Agreement*

As mentioned in the Letter from the Chairmen, the services under the Comprehensive Services Framework Agreement include the following transactions:

- D. Construction and overhaul services including the provision of construction services for production plants, equipment and production process and the purchase of the relevant machineries and equipment, inspection and maintenance and etc;
- E. Financial services including approved banking services such as payment collection services, deposit account and related interest income, loan services and etc;
- F. Insurance services including insurance coverage for property, facilities and inventory and etc;
- G. Research and development services including the sub-contract of research and development by the Company and etc; and
- H. Rental services include the rental of land by the Company and etc;

LETTER FROM PARTNERS CAPITAL

As advised by the Company, the above transactions are part of the ordinary and usual course of the Company's business and are crucial and beneficial to the Company's overall operation. Given that the respective amounts of the Non-Exempt Continuing Connected Transactions (namely Transactions (A), (B), (D) and (E) above) exceed HK\$10 million and the relevant applicable ratios under Rule 14.07 of the Listing Rules exceed 2.5%, whilst the agency sales of products, whose relevant applicable ratio exceed 0.1% but less than 2.5% as they are aggregated in the same category of sales of products and services, certain continuing connected transactions under the respective Framework Agreement entered into between the Company, Sinopec Corp and Sinopec Group Company constitute non-exempt continuing connected transaction pursuant to the Listing Rules and the Non-Exempt Continuing Connected Transactions are subject to reporting, announcement, and the Independent Shareholders' approval requirements under the Listing Rules.

B. *Rationale for each of the Transactions (A), (B), (C), (D) and (E)*

- *Transaction (A)*

As advised by the Company, notwithstanding that the gradual deregulation of the oil and petrochemical industry in the PRC after its admission to the World Trade Organisation, there are still a limited number of companies (which includes the Group, Sinopec Corp, Sinopec Group Company and their certain respective associates, as the case may be) which are allowed to engage in the sale and purchase of oil and petrochemical products in the PRC. In addition, transactions involving crude oil are subject to State allocation. In accordance with the State plan, the Company's imported crude oil is allocated by Sinopec Corp and the Company imports crude oil through the associates of Sinopec Corp. The Company also purchases domestically-produced crude oil, other raw materials (such as methanol, naphtha, methyl tertiary-butyl ether and residue) and auxiliary materials (such as catalysts) from the associates of Sinopec Corp. Accordingly, the allocation of raw materials to the Company is governed by State regulations and administrative measures of Sinopec Corp. As such, the Company has been inevitably and primarily conducting its oil and petrochemical related business with Sinopec Corp, Sinopec Group Company and their respective associates (as the case may be). Furthermore, as advised by the Company, Sinopec Corp has been the major supplier of crude oil in the PRC market and the Group has been provided with stable and quality supplies of crude oil at market price.

On the above basis, we consider that it is in the interest of the Company to purchase crude oil, other raw materials and auxiliary materials from Sinopec Corp and/or its associates in order to secure a stable supply of raw materials for its business operations.

- *Transaction (B)*

As advised by the Company, notwithstanding that the gradual deregulation of the oil and petrochemical industry in the PRC after its admission to the World Trade Organisation, there are still a limited number of companies (which includes the Group, Sinopec Corp, Sinopec Group Company and their certain respective associates, as the case may be) which are allowed to engage in the sale and purchase of oil and petrochemical products in the PRC. In addition, China's oil and petrochemical industry has always been the subject of extensive regulation by the

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PRC government. Transactions involving the sale and purchase of petroleum products are controlled by the PRC government. Accordingly, the Company's sales of petroleum products are governed by the relevant PRC regulations and measures. These regulations and measures dictate the transaction value, the volume and all other terms and conditions at which the Company conducts its sales of petroleum products.

On the above basis, we consider that it is in the interest of the Company to conduct sales of petroleum products to Sinopec Corp and its associates in order to secure a stable revenue streams to the Group.

- *Transaction (C)*

As set out in the Letter from the Chairman, the Company conducts its sales of petrochemical products primarily by its sales personnel at the moment. As advised by the Company, the Company considers the broadening of its trading, distribution and marketing network to be beneficial. Given that Sinopec Corp is one of the largest petrochemical companies in Asia and has a strong trading, distribution and marketing network, the Company believes that it will benefit from Sinopec Corp's experience, expertise and strong global network and will increase the sales of its petrochemical products and improve the Company's bargaining position with customers. As further advised by the Company, it is difficult for the Company to build up a sales network similar to that of Sinopec Corp by its own sales team.

On the above basis, we consider that the leveraging on the Sinopec Corp's leading position in the petrochemical industry and its sales network is in the interest of the Company and its shareholders as a whole as it would allow the Group to have a wider distribution network with stronger bargaining power in price and quantity.

- *Transaction (D)*

As set in the Letter from the Chairman, the Company has from time to time obtained in the ordinary and usual course construction and overhaul services from Sinopec Group Company and its associates, in order to construct and overhaul its production or other facilities. The construction and overhaul also requires the purchase of equipment from Sinopec Group Company and its associates. We note from the Letter from the Chairman that there are few major construction projects for the 2005–2007 period and we were advised by the Company that major specialist teams on petrochemical construction and overhaul services are concentrated in Sinopec Group Company and its associates. We were further advised by the Company that although the Group has its own maintenance team, the Group does not have its own specialist teams on large petrochemical construction and overhaul services and thus, the Company consider that subcontracting the relevant construction work and services to the specialist teams of Sinopec Corp allows the Company to obtain stable, reliable and high-quality services for its construction and overhaul of production and other facilities. In addition, the Company considers that it may be costly to maintain its own specialist teams on petrochemical construction and overhaul services given that the Company may not have construction projects on an annual recurring basis. On the other hand, as advised by the Company, the construction projects require the purchase of equipment. The Company considers that it is beneficial to the Company

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that the associate of Sinopec Corp to carry out a bulk purchase of equipment for the Company and Sinopec Corp instead of obtaining the equipment by the Company directly given that there are usually discounts on bulk purchases.

On the above basis, we consider that the subcontract of petrochemical construction and overhaul services and purchase of equipment to the specialist teams of Sinopec Corp is in the interest of the Company and its shareholders as a whole.

- *Transaction (E)*

As set out in the Letter from the Chairman, the Company sells petroleum products to Sinopec Corp and its associates. Sinopec Corp and its associates make payment to the Company through Sinopec Finance Company Limited at which the Company has opened a settlement account. Sinopec Finance Company Limited is a non-bank finance company approved and regulated by the People's Bank of China ("PBOC") and the China Banking Regulatory Commission ("CBRC"), and is an associate of Sinopec Group Company. The Company earns interest on the outstanding balance of the settlement account prior to the funds being transferred to Company's accounts opened with commercial banks. As advised by the Company, the services provided by Sinopec Finance Company Limited and the charges thereof are more or less the same as compared to an ordinary commercial bank in the PRC. We were further advised by the Company that it will open a deposit account to replace the settlement account with Sinopec Finance Company and Sinopec Finance Company shall accept deposits from the Company at interest rates not lower, and thus no less favourable, than the relevant standard rates set by the PBOC for similar deposits.

On the basis that Sinopec Finance Company Limited is providing the regulated financial services which are generally provided by a commercial bank in the PRC and offers the Company with no less favourable terms than the relevant standard rates set by the PBOC, we consider that it is in the interest of the Company to obtain timely financial services from Sinopec Finance Company Limited.

Against all the background as stated above, we consider that there is a strong rationale for the Company to enter into the Framework Agreements with Sinopec Corp and Sinopec Group Company respectively.

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(ii) Pricing mechanisms and Caps of the Non-Exempt Continuing Connected Transactions

Caps for the Non-Exempt Continuing Connected Transactions under the Framework Agreements for the three years ending 31 December 2007 and the historical amounts of the Non-Exempt Continuing Connected Transactions for the three years ended 31 December 2004 are set out as follows:

	Historical figures			Estimated annual Caps		
	31 December 2002 <i>(RMB million)</i>	31 December 2003 <i>(RMB million)</i>	31 December 2004	31 December 2005 <i>(RMB million)</i>	31 December 2006 <i>(RMB million)</i>	31 December 2007
Transaction (A)	5,765 (equivalent to approximately HK\$5,543 million)	8,311 (equivalent to approximately HK\$7,991 million)	14,928 (equivalent to approximately HK\$14,354 million)	37,619 (equivalent to approximately HK\$36,172 million)	55,192 (equivalent to approximately HK\$53,069 million)	78,965 (equivalent to approximately HK\$75,928 million)
Transaction (B)	14,575 (equivalent to approximately HK\$14,014 million)	21,365 (equivalent to approximately HK\$20,543 million)	32,124 (equivalent to approximately HK\$30,888 million)	53,973 (equivalent to approximately HK\$51,897 million)	74,622 (equivalent to approximately HK\$71,752 million)	102,155 (equivalent to approximately HK\$98,226 million)
Transaction (C)	0	0	0	74 (equivalent to approximately HK\$71 million)	153 (equivalent to approximately HK\$147 million)	192 (equivalent to approximately HK\$185 million)
Transaction (D)	383 (equivalent to approximately HK\$368 million)	1,178 (equivalent to approximately HK\$1,133 million)	788 (equivalent to approximately HK\$758 million)	3,100 (equivalent to approximately HK\$2,981 million)	12,170 (equivalent to approximately HK\$11,702 million)	13,434 (equivalent to approximately HK\$12,917 million)
Transaction (E) (Deposits and related interest income only)	0	0	0	1,752 (equivalent to approximately HK\$1,685 million)	1,902 (equivalent to approximately HK\$1,829 million)	1,952 (equivalent to approximately HK\$1,877 million)

Source: the Letter from the Chairman

- *Transaction (A)*

Pursuant to the Mutual Supply Servicing Framework Agreement, the terms of the actual transactions under Transaction (A) will be determined according to the prevailing market practice and conditions upon the individual supply contract for single transaction is to be executed whilst the pricing for the transactions will be determined in accordance with the following general pricing principles:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the Company's purchases shall be bound by the State tariffs; or

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- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the Company's purchases shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the pricing of the Company's purchases shall be determined in accordance with the prevailing market price (including any bidding price).

We note that the priority of the pricing mechanism follows the sequence from (a) to (c) as stated above. As such, we consider that such pricing mechanism can ensure the Company to comply with the relevant rules and regulations on the pricing of purchase of raw materials (in the case of pricing principles (a) and (b)) whilst facilitating the Company to pay the prevailing market rates at all times and thus, it is fair and reasonable to the Company to adopt such pricing mechanism.

As advised by the Company, given that the oil and petrochemical industries are subject to extensive regulations and control by the PRC government, the consideration of the transactions involving oil and petrochemical in the PRC markets have been using the then State tariffs or the State guidance prices. In addition, given that there are limited suppliers of crude oil and petrochemical products in the PRC, in order to fulfill the expected increase in demand, the Company intends to increase its purchases from the Sinopec Corp, Sinopec Group Company and their respective associates (as the case may be).

We were advised by the Company that the annual Caps for Transaction (A) were determined with reference to: (i) the previous transactions conducted and transaction amounts in respect of purchases of raw materials from Sinopec Corp and its associates; (ii) the Company's estimate of its business growth as well as the increase in the demand of its products; (iii) the Company's estimate of the increase in its production capacity (after the completion of the expansion to 20 million tpa refining capacity expansion project); and (iv) the estimated increase in the cost of raw materials such as crude oil and processed oil which were estimated by the Company based on the experience and expertise of the Directors and other management. Furthermore, as advised by the Directors, the Company will perform market research to compare the pricing before agreeing the price with the suppliers upon execution of the respective agreements.

As further advised by the Company, the throughputs of feedstock of the Group during the period from 2002 to 2007 are as follows:

	Historical figures			Estimated annual Caps		
	31 December 2002	31 December 2003	31 December 2004	31 December 2005	31 December 2006	31 December 2007
	('000 tonnes)			('000 tonnes)		
Throughput of feedstock	11,946	13,631	16,141	18,000	20,000	22,000

Source: Annual reports of the Company for 2003 and 2004 and the Letter from the Chairman

We note that the average annual increase of throughput of feedstock during 2002 to 2004 was approximately 16% whilst that the annual increase of throughput of feedstock during 2005 to 2007 is expected to be approximately 11%. We also note from the annual report of the Company for the year ended 31 December 2004 that the average dated price of the

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Brent crude oil for the entire year was approximately US\$38.27/barrel, representing an increase of approximately 33% from that of the previous year. As advised by the Company, after completion of the expansion to 20 million tpa refining capacity expansion project, the production capacity will increase and give rise to the increased need for crude oil and other raw materials. According to the research report from Goldman Sachs in September 2005, they estimated that the price of the Brent crude oil may reach approximately US\$56/barrel and approximately US\$66/barrel in 2005 and 2006 respectively in the international market which is in line with the Company's estimation.

On the basis that the prices of raw materials and the throughputs of feedstock are expected to be increasing and assuming that the Company may have difficulty in obtaining the relevant raw materials for a large volume from independent suppliers, we are of the view that the bases on which the annual Caps were determined are fair and reasonable and in the interest of the Shareholders and the Company as a whole.

- *Transaction (B)*

Pursuant to the Mutual Supply Servicing Framework Agreement, the terms of the actual transactions under Transaction (B) will be determined according to the prevailing market prices and conditions upon the individual supply contract for single transaction is to be executed and the pricing for the transactions will be determined in accordance with the following general pricing principles:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the Company's sales shall be bound by the State tariffs; or
- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the Company's sales shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the pricing of the Company's sales shall be determined in accordance with the prevailing market price (including any bidding price).

We note that the priority of the pricing mechanism follows the sequence from (a) to (c) as stated above. As such, we consider that such pricing mechanism can ensure the Company to comply with the relevant rules and regulations on the pricing of sales of product (in the case of pricing principles (a) and (b)) whilst facilitate the Company to provide terms which are no less favourable than terms available from independent third parties when pricing principles (a) and (b) are not applicable and thus, it is fair and reasonable for the Company to adopt such pricing mechanism.

As further advised by the Company, given that the oil and petrochemical industries are subject to extensive regulations and control by the PRC government, the consideration of the transactions involving oil and petrochemical in the PRC markets have been using the then State tariffs or the State guidance prices. In addition, the annual Caps for Transaction (B) were determined with reference to: (i) the previous transactions conducted and transaction amounts in respect of sales of products and provision of services to Sinopec Corp and its associates (including Yizheng); (ii) the Company's estimate of the increase in the costs of raw materials; (iii) the Company's estimate of the increase in the overall demand for petroleum products in the PRC; and (iv) the Company's estimate of the increase in the market price of petroleum products and the market price of services

which were predicted by the Company based on the experience and expertise of the Directors and other management. Furthermore, as advised by the Directors, the Company will perform market research to compare the pricing before agreeing the price with the customers upon execution of the respective agreement.

We note that the annual increase for the amount of the Transaction (B) during 2002 to 2004 was approximately 48% whilst the expected annual increase for the amount of the Transaction (B) during 2004 to 2007 is also approximately 48%. As advised by the Company, it is expected that by the end of 2006, the Company will complete construction and commence operation of a 1.5 million tpa hydrocracking unit and related auxiliary facilities, and will increase its comprehensive processing capacity to 20 million tpa. The completion of the new projects will significantly increase the production capacity of the Company. Accordingly, the Company expects that its sales would increase as a result of an enlarged production capacity given the demand for petroleum products has been increasing in phase with the production capacity over the years.

Based on the above and on the basis that the prices of products of the Group are expected to be increasing, we are of the view that the bases on which the annual Caps were determined are fair and reasonable and in the interest of the Shareholders and the Company as a whole.

- *Transaction (C)*

Pursuant to the Mutual Supply Servicing Framework Agreement, the commissions payable to Sinopec Corp and its associates in connection with the agency sales of the Company's petrochemical products are determined on the prevailing market percentage commission of the agency sales of the Company's petrochemical products. Agency sales of products, whose relevant applicable ratio exceed 0.1% but less than 2.5%, are also Non-Exempt Continuing Connected Transactions as they are aggregated in the same category of sales of products and services.

Currently, the Company sells its petrochemical products primarily by its sales persons. As set out in the Letter from the Chairman, trading, distribution and marketing of the Company's products are important elements in the success of the business of the Company and the Company considers the broadening of its trading, distribution and marketing network to be beneficial. Sinopec Corp is one of the largest petrochemical companies in Asia and has a strong trading, distribution and marketing network. As advised by the Company, the sales of petrochemical products are expected to increase significantly in the next three years. Thus, the Company believes that it will benefit from Sinopec Corp's experience, expertise and strong global network and will increase the sales of its petrochemical products and improve the Company's bargaining position with other customers (which do not include Sinopec Corp and its associates). As advised by the Company, it is expected that the agency sales of products will commence in the second half of 2005. Pursuant to the Mutual Supply Framework Agreement, the commissions payable to Sinopec Corp and its associates in connection with the agency sales of the Company's petrochemical products are determined on the prevailing market percentage commission of the agency sales of the Company's petrochemical products. As advised by the Company, the commission rate for the agency sales of products is expected to be 0.9% for 2005 (which is the prevailing market rate at the moment) and may subject to further adjustment should there be changes in the then prevailing market conditions. We have identified certain transactions in relation to agency sales of petrochemical products in the

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PRC by Sinopec Group Company and/or its associates in 2005 and noted that the said commission rate falls within the range of such comparable transactions. Accordingly, we consider that such commission rate to be charged by Sinopec Corp and its associates is fair and reasonable.

The annual Caps for the transactions under Transaction (C) have been determined with reference to (i) the sales amounts of the Company's petrochemical products in the past. For the three years ended 31 December 2004, the sales of the Company's petrochemical products amounted to RMB1,947 million (equivalent to approximately HK\$1,872 million), RMB3,068 million (equivalent to approximately HK\$2,950 million) and RMB6,339 million (equivalent to approximately HK\$6,095 million) respectively; (ii) the Company's estimate of the increase in the overall demand for petrochemical products in the PRC; (iii) the Company's estimate of its business growth; and (iv) the Company's estimate of prevailing market percentage commission of the agency sales of petrochemical products. As such, the Company expects that the commissions payable to Sinopec Corp and its associates in relation to agency sales of the Company's petrochemical products will increase in 2005, 2006 and 2007.

We note that the annual increase for the amount of the sales amounts of the Company's petrochemical products during 2002 to 2004 was approximately 82%. Assuming such sales were carried out by way of agency sales which would be charged at a fixed commission rate during 2002 to 2004, the annual increase for the commission would also be approximately 82%. As advised by the Company, the agency sales will take place in the second half of 2005 and it is expected that approximately 60% of the total petrochemical products will be sold under the agency sales in 2005. As such, the Cap for Transaction (C) for 2005 is expected to account for the 60% of the total commission for the agency sales assuming the agency sales had taken place since 1 January 2005. Thus, after annualise the Cap for the Transactions (C) for 2005, the expected annual increase of the Caps for Transaction (C) during 2005 to 2007 is approximately 25%. As advised by the Company, after completion of the expansion to 20 million tpa refining capacity expansion project, the Company expects that its sales would increase as a result of an enlarged production capacity given the demand for petroleum products has been increasing in phase with the production capacity over the years. Accordingly, the commission of agency sales of petrochemical products is also expected to increase.

Based on the above, we are of the view that the bases on which the annual Caps were determined are fair and reasonable and in the interest of the Shareholders and the Company as a whole.

- *Transaction (D)*

Pursuant to the Comprehensive Services Framework Agreement, the terms of the actual transactions under Transaction (D) will be determined according to the prevailing market prices and conditions upon the individual supply contract for single transaction is to be executed and pricing for the transactions will be determined in accordance with the following general pricing principles:

- (a) if there are applicable State (central and local governments) tariffs, the pricing of the construction and overhaul shall be bound by the State tariffs; or

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- (b) if there are no State tariffs, but there are applicable State guided prices, the pricing of the construction and overhaul shall be bound by the State guided prices; or
- (c) if there are no applicable State tariffs or State guided prices, the pricing of construction and overhaul shall be determined in accordance with the prevailing market price (including any bidding price); or
- (d) if none of the above applies, the Company's construction and overhaul pricing shall be determined on a cost plus basis. The margin shall be fixed at a rate not exceeding 6%.

We note that the priority of the pricing mechanism follows the sequence from (a) to (d) as stated above and the pricing mechanism in (d) would only apply in the event that pricing principles (a) to (c) are not applicable. In case that pricing mechanism (d) applies, we note that a margin will be charged by Sinopec Group Company and its associates. However, there is no publicly available comparable transaction to assess whether the said margin is fair and reasonable to the Company as the transactions using pricing mechanism (d) are usually unique, specialised projects which can only be undertaken by Sinopec Group Company and its associates who equipped with the required technical knowhow. Notwithstanding the aforesaid, we compare such margin against the lending rates in the PRC as we consider that companies in the PRC should seek a return higher than its cost of capital assuming such companies finance its operation purely by bank facilities. We note that the lending rates published by the PBOC range from 5.22% to 6.12% for short to medium term bank financing. Accordingly, we consider that the said margin falls within range of the said lending rates and is fair and reasonable to the Company. On the other hand, we consider that the above pricing mechanism ensures the Company to pay the prevailing market rates at all times and provides a cap on the amount to be payable by the Company in the event that pricing principles (a) to (c) are not applicable and thus, it is fair and reasonable to adopt such pricing mechanism.

The annual Caps for the transactions under Transaction (D) have been determined with reference to (i) the previous transactions conducted and transaction amounts in respect of provision of construction and overhaul services by Sinopec Group Company and its associates; (ii) the Company's estimate of the need of construction and overhaul services for the Company's existing and future development; and (iii) the Company's estimate of the increase in the market price of construction and overhaul services.

As set out in the Letter from the Chairman, the contracts on major construction projects for the 2005–2007 period include the following:

- (a) the Company will invest from 2005 to 2007 a sum of RMB4.1 billion (equivalent to approximately HK\$3.9 billion) to complete the 20 million tpa refinery capacity expansion project;
- (b) from 2005 onwards, the Company will commence the 1 million tpa ethylene project with a total investment estimated at RMB21.5 billion (equivalent to approximately HK\$20.7 billion); and
- (c) the major overhaul in 2006 and scattered maintenance projects to be carried annually is estimated to have annual transaction values of approximately RMB500 million (equivalent to approximately HK\$481 million).

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As set out in the Letter from the Chairman, in light of the possibility of a certain degree of increase in equipment and material prices when actual investment takes place, and in light of the possibility that certain projects may be carried out earlier or later than the schedule due to adjustments made to the actual investment in each year in accordance with market situation and project progress, the caps for 2006 and 2007 were determined by allowing a 10% rise on the estimated total investment for each of the years 2006 and 2007, plus 20% of the caps for the previous year in the caps for the following year.

We have identified certain projects undertaken by Sinopec Group Company and/or its associates in 2005 with sizes similar to those to be undertaken by the Group and we note that the budgets of such comparable transactions were comparable to that of those projects to be undertaken by the Group.

In view of the above projects, we are of the view that the bases on which the annual Caps were determined are fair and reasonable and in the interest of the Shareholders and the Company as a whole.

- *Transaction (E)*

Pursuant to the Comprehensive Services Framework Agreement, (i) the collection and payment services will be provided by Sinopec Finance Company free of charge to the Company; and (ii) Sinopec Finance Company shall accept deposits from the Company at interest rates not lower, and thus no less favourable, than the relevant standard rates set by the PBOC for similar deposits.

Given that Sinopec Finance Company will provide collection and payment services free of charge and accept deposits from the Company at interest rates not lower, and thus no less favourable, than the relevant standard rates set by the PBOC for similar deposits, we consider that the terms in relation to pricing are fair and reasonable to the Company.

The annual Caps for Transaction (E), which represents the maximum of the deposit account (including related interest income) established to replace the settlement account, were determined with reference to (i) the previous balances of the settlement account with Sinopec Finance Company Limited; (ii) the Company's estimate of its business growth; and (iii) the estimated volume of the Company's sales with Sinopec Corp and its associates.

As set out in the Letter from the Chairmen, the Company believes that having reliable and cooperative financial services are important to its business as the nature of the Company's business means that transactions often involve large sums of money. The ability to obtain timely financial services in respect of collecting and making payments, deposit and loan facilities is essential to the Company's management of its cashflow requirements, allowing the Company to earn higher return on excess cash and obtain necessary financial resources in time of capital shortage. We were advised by the Company that the cashflow from connected parties will increase as the sales of products to connected parties increase. In addition, we note that the settlement balance as at 31 December 2004 was approximately RMB1,627 million (equivalent to approximately HK\$1,564 million) and the Cap for 2005 is set at RMB1,752 million (equivalent to approximately HK\$1,685 million) representing an increase of approximately 8%. Given that the deposit account

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will replace the settlement account, we consider that aforesaid comparison is appropriate. We further note that the expected annual increase for the amount of the Transaction (E) during 2005 to 2007 is approximately 6%.

Based on the above, we are of the view that the bases on which the annual Caps were determined are fair and reasonable and in the interest of the Shareholders and the Company as a whole.

As a summary, given that the relevant terms of individual agreement will be determined upon execution with reference to the then prevailing market conditions and the above pricing principles, we consider that the Non-Exempt Continuing Connected Transactions are to be carried out on normal commercial terms and in the ordinary course of business and the bases on which the annual Caps were determined are fair and reasonable and in the interest of the Shareholders and the Company as a whole.

(iii) The conditions

As the respective amounts of the Non-Exempt Continuing Connected Transactions exceed HK\$10 million and the relevant applicable ratios under Rule 14.07 of the Listing Rules exceed 2.5% whilst the agency sales of products, whose relevant applicable ratio exceed 0.1% but less than 2.5%, are also considered as Non-Exempt Continuing Connected Transactions as they are aggregated in the same category of sales of products and services, the Non-Exempt Continuing Connected Transactions are subject to reporting, announcement, and the Independent Shareholders' approval requirements under the Listing Rules.

The Company will therefore seek the approval by the Independent Shareholders of the Framework Agreements, the Non-Exempt Continuing Connected Transactions including the Caps for the three financial years ending 31 December 2007 subject to the following conditions:

1. The Non-Exempt Continuing Connected Transactions will be:
 - (i) entered into by the Company in the ordinary and usual course of its business;
 - (ii) conducted on normal commercial terms or, if there are no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available from independent third parties; and
 - (iii) entered into in accordance with the terms of the Framework Agreements governing such Non-Exempt Continuing Connected Transactions that are fair and reasonable and in the interests of the shareholders of the Company as a whole;
2. The respective transacted amount of the transactions under the Framework Agreements for the three years ending 31 December 2007 shall not exceed the respective Cap as stated above;
3. The Company will comply with all other relevant requirements under the Listing Rules.

Taking into account of the conditions attached to the Non-Exempt Continuing Connected Transactions, in particular (i) the restriction by way of setting the Caps; and (ii) the compliance with all other relevant requirements under the Listing Rules (which include the annual review

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and/or confirmation by the independent non-executive Directors and auditors of the Company on the actual execution of the Non-Exempt Continuing Connected Transactions), we consider that the Company has taken appropriate measures to govern the Company in carrying out the Non-Exempt Continuing Connected Transactions, thereby safeguarding the interests of the Shareholders thereunder.

RECOMMENDATION

Having considered the above factors, in particular,

- (1) the background of and the reasons for carrying out the Non-Exempt Continuing Connected Transactions;
- (2) the Non-Exempt Continuing Connected Transactions are crucial and beneficial to the Group's overall operation;
- (3) the basis of setting the Caps, and
- (4) it is a condition that the Non-Exempt Continuing Connected Transactions will be carried out by the Company in the ordinary and usual course of its business, on normal commercial terms, and in the interests of the shareholders of the Company as a whole,

we consider that the Non-Exempt Continuing Connected Transaction are to be carried out on normal commercial terms and in the best interests of the Company and its shareholders as a whole and the terms of the Framework Agreements and the Non-Exempt Continuing Connected Transactions (including the Caps) are fair and reasonable so far as the Independent Shareholders are concerned. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution approving the Framework Agreements and the Non-Exempt Continuing Connected Transactions (including the Caps) to be proposed at the Extraordinary General Meeting.

Yours faithfully,

For and on behalf of

Partners Capital International Limited

Alan Fung

Harry Yu

Managing Director

Director

NOTICE OF EXTRAORDINARY GENERAL MEETING



中國石化鎮海煉油化工有限公司 SINOPEC ZHENHAI REFINING & CHEMICAL COMPANY LIMITED

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

(Stock Code: 1128)

NOTICE IS HEREBY GIVEN that the extraordinary general meeting (the “EGM”) of Sinopec Zhenhai Refining & Chemical Company Limited (the “Company”) will be held at the conference room on the 1st floor of Donghai Hotel at the Company’s premises at Zhenhai District, Ningbo Municipality, Zhejiang Province, the People’s Republic of China (the “PRC”) on Friday, 11 November 2005, at 10:30 a.m. to review and, if appropriate, pass the following resolution as ordinary resolution:

1. (a) To approve and pass, in general and unconditionally, the Mutual Supply Framework Agreement (please refer to the definition contained in the circular regarding the continuing connected transactions dated 16 September 2005 (the “Circular”)) and the non-exempt continuing connected transactions (please refer to the definition contained in the Circular) contemplated under the Mutual Supply Framework Agreement and to authorize, confirm and approve that any Executive Directors of the Company are authorised to take all actions and carry out execution of all documents in accordance with their personal opinions under necessary, required and appropriate conditions, in order to implement and validate anything related to and conditional on the Mutual Supply Framework Agreement;
- (b) To approve and pass, in general and unconditionally, the Comprehensive Service Framework Agreement (please refer to the definition contained in the Circular) and the non-exempt continuing connected transactions (please refer to the definition contained in the Circular) contemplated under the Comprehensive Service Framework Agreement and authorize, confirm and approve that any Executive Directors of the Company are authorised to take all actions and carry out execution of all documents in accordance with their personal opinions under necessary, required and appropriate conditions, in order to implement and validate anything related to and conditional on the Comprehensive Service Framework Agreement; and
- (c) To approve and pass the caps (please refer to the definition contained in the Circular) related to the non-exempt continuing connected transactions for the years ending 31 December 2005, 31 December 2006 and 31 December 2007 respectively.

By Order of the Board
Su Dewen
Company Secretary

16 September 2005, Ningbo, the PRC

NOTICE OF EXTRAORDINARY GENERAL MEETING

Notes:

1. ELIGIBILITY FOR ATTENDING THE EGM

Shareholders of the Company whose names appear on the register of members kept at Hong Kong Registrars Limited at the close of business on Wednesday, 12 October 2005 are eligible to attend and vote at the EGM. Shareholder or his proxy is entitled to cast one vote for each share held.

In order to be eligible to attend and vote at the EGM of the Company to be held on Friday, 11 November 2005, all transfers together with the relevant share certificates must be delivered to the Company's H share registrar in Hong Kong — Hong Kong Registrars Limited, at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not later than 4:00 p.m. on Monday, 10 October 2005.

2. PROXY

- (1) A shareholder eligible to attend and vote at the EGM is entitled to appoint one or more proxies in writing to attend and vote at the EGM on his behalf. A proxy need not be a shareholder of the Company.
- (2) A shareholder should appoint his proxy in writing. The proxy form must be signed by the shareholder or the proxy authorised in writing, or if the proxy form is signed by another person authorised by the shareholder, any authorisation documents of such an appointment must be notarised.
- (3) The proxy form of H share's shareholder together with the power of attorney or other authority, if any, under which it is signed or a notarially certified copy of such power or authority must be lodged at the Company's share registrar in Hong Kong not less than 24 hours before the time for holding the meeting to be valid.
- (4) A proxy may exercise the right to vote by raising his hand or by poll. However, if more than one proxy is appointed by a shareholder, such proxies shall only exercise the right to vote by poll.

3. REGISTRATION PROCEDURES FOR ATTENDING THE EGM

- (1) A shareholder or his proxy shall produce proof of identity when attending the meeting.
- (2) Holders of H shares who intend to attend the meeting shall complete and lodge the reply slip and return the same to the Company or its Hong Kong share registrar on or before Friday, 21 October 2005.
- (3) The reply slip may be delivered by hand, by post, or by fax.

4. REGISTRATION OF SHARE TRANSFERS

The register of members of the Company will be closed from Wednesday, 12 October 2005 to Friday, 11 November 2005 (both days inclusive).

NOTICE OF EXTRAORDINARY GENERAL MEETING

5. VOTE ON RESOLUTION BY WAY OF POLLING

The resolution of the EGM held on Friday, 11 November 2005 will demand the vote to be carried out by way of polling. Details of the polling are contained in Appendix II of the Company's Circular dispatched on Friday, 16 September 2005.

6. OTHER BUSINESSES

(1) It is expected that the EGM will not last for more than one day. Shareholders who attend shall bear their own travelling and accommodation expenses.

(2) The fax number of the Company is (86-574) 86456155.

RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. 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.

DISCLOSURE OF INTERESTS**(a) Interests of Directors and Supervisors**

- (i) As at the Latest Practicable Date, neither the Directors nor the Supervisors of the Company had any interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Hong Kong Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), the Model Code for Securities Transactions by Directors of Listed Companies and which were required to be entered in the register required to be kept under section 352 of the SFO.
- (ii) None of the Directors or the Supervisors has any direct or indirect interest in any assets which have since 31 December 2004 (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.
- (iii) None of the Directors or the Supervisors is materially interested in any contract or arrangement entered into by the Company subsisting at the date of this circular which is significant in relation to the business of the Group.

(b) Interests of Shareholders

As at the Latest Practicable Date, save as disclosed below, the Directors of the Company were not aware of any persons (other than Directors and Supervisors of the Company and their respective associate(s)) who had an interest or short position in the Shares or underlying shares of the Company which would fall to be disclosed to the Company under provisions of Divisions 2 and 3 of Part XV of the SFO or were directly or indirectly interested in 10% or more of the nominal value of the issued share capital carrying rights to vote in all circumstances at general meeting of any other member of the Group:

(i) *the Company*

Name of Shareholder	Nature	Class of Shares	Capacity	Note	Number of shares/ underlying shares	% to entire issued capital	all issued H Shares
Sinopec Corp	Long position	State-owned legal person shares	Corporate	a	1,800,000,000	71.32	N/A

Name of Shareholder	Nature	Class of Shares	Capacity	Note	Number of shares/ underlying shares	% to entire issued capital	all issued H Shares
BP Plc	Long position	H shares	Corporate	b	237,600,000	9.41	32.83
JP Morgan Chase & Co.	Long position	H shares	Beneficial owner/ Investment manager/ Custodian	c	48,893,000	1.94	6.76
	Lending Pool	H shares	N/A	c	9,619,000	0.38	1.33
FMR Corp	Long position	H shares	Investment manager		42,086,000	1.67	5.81

Notes:

- (a) Sinopec Corp held the above 1,800,000,000 state-owned legal person shares in the Company. Sinopec Group Company is the ultimate controlling shareholder of the Company, and is a state-authorised investment institution and a state-holding company. It has a 67.92% equity interest in Sinopec Corp.
- (b) BP Products North America Inc., which was a controlled corporation of BP Plc, had a direct holding in the above 237,600,000 H shares.
- (c) The shares in which JP Morgan Chase & Co. was deemed to be interested were held via JP Morgan Chase Bank, N.A., J.P. Morgan Whitefriars Inc., JF Asset Management Limited and JF International Management Inc. respectively.

(ii) *Other members of the Group*

Name of Subsidiary	Other Substantial Shareholders	Equity interest
Ningbo Bonded Area Zhenhai Refining & Chemical International Trading Company	Ningbo Economic & Technical Development Zone Zhenhai Refining & Chemical Warehousing Company	10%
Ningbo Jinchen Trading Company Limited	Ningbo Bonded Area Zhenhai Refining & Chemical International Trading Company	10%
Ningbo Donghai Petrochemical Company Limited	Ningbo Bonded Area Zhenhai Refining & Chemical International Trading Company	10%

COMPETING INTEREST

As at the Latest Practicable Date, in so far as the Directors were aware, none of the Directors or their respective associates had any interest in a business which competed or was likely to compete with the business of the Group.

SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors or the Supervisors had entered into any service contracts with the Company or any member of the Group, other than contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation).

MATERIAL CHANGE

The Directors confirm that, as at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2004 (being the date to which the latest published audited financial statements of the Company were made up).

LITIGATION

The Company is not engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors or the Company to be pending or threatened by or against the Company or any of its subsidiaries.

EXPERT

- (a) The following is the qualification of Partners Capital which has given its opinion or advice which is contained in this circular:

Name	Qualifications
Partners Capital	a licensed corporation to carry out types 1 and 6 regulated activities (dealing in securities and advising on corporate finance) under the SFO

- (b) Partners Capital does not have any shareholding, direct or indirect, in any member of the Group or any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.
- (c) Partners Capital has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter and references to its name in the form and context in which they are included.
- (d) Partners Capital does 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 2004, the date to which the latest published audited financial statements of the Company were made up.
- (e) The letter and recommendation given by Partners Capital are given as of the date of this circular for incorporation herein.

MISCELLANEOUS

- (a) The company secretary of the Company is Mr. Su Dewen who holds the title of economist.

- (b) The Company has not employed a qualified accountant with the qualifications specified in the rule 3.24 of the Listing Rules. The Company will use its best endeavour to identify and recruit a suitable candidate to take up the position as soon as practicable. An announcement will be made after the appointment of the qualified accountant specified under rule 3.24 of the Listing Rules.
- (c) The registered office and head office of the Company is Zhenhai District, Ningbo Municipality, Zhejiang Province, the PRC, Postcode: 315207.
- (d) The place of business of the Company in Hong Kong is at 17th Floor, Prince's Building, 10 Chater Road, Central, Hong Kong.
- (e) The share registrar of the Company is Hong Kong Registrars Limited, Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection at the offices of Johnson Stokes & Master at 16/F–19/F, Prince's Building, 10 Chater Road, Central, Hong Kong during normal business hours for a period of 14 days from the date of this circular:

- (a) the articles of association of the Company;
- (b) the letter from the Independent Board Committee, the text of which is set out on page 25 of this circular;
- (c) the letter from Partners Capital, the text of which is set out on pages 26 to 40 of this circular;
- (d) the written consent of Partners Capital;
- (e) the Mutual Supply Framework Agreement; and
- (f) the Comprehensive Services Framework Agreement.

According to the Articles of Association of the Company, a poll may be demanded by:

- (1) the chairman of the meeting;
- (2) at least two qualified shareholders or two proxies of qualified shareholders;
- (3) one or more qualified shareholders (including proxies), individually or in aggregate, representing 10% or more of all the voting shares at the meeting.

Unless a poll is requested, a declaration shall be made by the chairman of the meeting that a resolution has been passed by a show of hands. The request for a poll may be withdrawn by the person who requests the same.