

Report of the Directors

The directors (the "Directors") of CNOOC Limited (the "Company") are pleased to present their report together with the audited financial statements for the year ended December 31, 2001.

Principal Activities and Operating Results

The principal activity of the Company is investment holding of its subsidiaries (which together with the Company shall be known as the "Group"), which are principally engaged in the exploration, development, production and sales of crude oil and natural gas.

Summary of Financial Information

Please refer to the financial statements for a summary of the assets and liabilities of the Group as at December 31, 2001 on page 43 and the operating results for the year then ended on page 42.

Loans

Please refer to note 19 to the financial statements on pages 66 to 67 for details of the long-term bank loans of the Group for the year ended December 31, 2001.

Property, Plant and Equipment

Please refer to note 13 to the financial statements on pages 61 to 62 for movements in property, plant and equipment of the Group for the year ended December 31, 2001.

Reserves

Please refer to note 26 of the financial statements on pages 70 to 71 for movements in the reserves of the Group for the year ended December 31, 2001.

Subsidiaries and Associated Company

Particulars of the Company's subsidiaries and associated company as at December 31, 2001 are set out in notes 14 and 15 to the financial statements on pages 62 to 64.

Dividends

The Directors recommend the payment of a final dividend of HK\$0.15 per share for the year ended December 31, 2001.

Retirement Benefits

Please refer to note 27 to the financial statements on page 71 for details of the retirement benefits of the Group for the year ended December 31, 2001.

Major Suppliers and Customers

Purchases from the largest supplier of the Group for the year ended December 31, 2001 represented approximately 15% of the Group's total purchases. The total purchases attributable to the five largest suppliers of the Group accounted for approximately 45% of the total purchases of the Group for the year then ended.

Sales to the largest customer for the year ended December 31, 2001 represented approximately 30% of the Group's total sales. The total sales attributable to the five largest customers of the Group accounted for approximately 51% of the total sales of the Group for the year then ended.

None of the Directors or their respective associates (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") or any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interests in the five largest suppliers or customers of the Group for the year ended December 31, 2001.

Connected Transactions

The Independent Non-executive Directors confirmed that the connected transactions for the year ended December 31, 2001 to which the Group was a party and the agreements governing those transactions were entered into by the Group:

1. in the ordinary and usual course of its business;
2. either (a) on normal commercial terms, or (b) where there was no available comparison, on terms no less favourable than those available to independent third parties; and
3. on terms that were fair and reasonable so far as the shareholders of the Company were concerned.

The Independent Non-executive Directors further confirmed that:

1. the aggregate annual volume of transactions under the materials, utilities and ancillary services supply agreements has not exceeded 10% of the audited consolidated total revenues of the Group in the immediate preceding financial year;
2. the aggregate annual volume of transactions in relation to technical services has not exceeded RMB3,800 million;
3. the aggregate annual volume of transactions in relation to research and development services for particular projects has not exceeded RMB150 million;
4. the aggregate annual volume of transactions in relation to sales of crude oil, condensate oil and liquefied petroleum gas has not exceeded 25% of the audited consolidated total revenues of the Group in the immediate preceding financial year;
5. the amount paid under the general research and development services agreement has not exceeded RMB110 million; and
6. the aggregate amounts paid under the lease and management agreements have not exceeded RMB55 million.

The auditors of the Group have reviewed the connected transactions and confirmed to the Directors that:

1. the transactions have received the approval of the Directors;
2. the transactions were in accordance with the pricing policies as stated in the Company's financial statements; and

3. the transactions were entered into in accordance with the terms of the agreements governing the transactions.

Please refer to note 28 to the financial statements on pages 72 to 73 for a summary of the connected transactions.

Share Capital

Please refer to note 24 to the financial statements on pages 68 to 69 for details of movements in the Company's share capital for the year ended December 31, 2001.

Share Option Scheme and Pre-Global Offering Share Option Scheme

On February 4, 2001, the Company adopted a share option scheme (the "Share Option Scheme") for the purposes of recognizing the contribution that certain individuals have made to the Company and attracting and retaining the best available personnel to the Company. The Share Option Scheme became effective on February 4, 2001 and, unless otherwise cancelled or amended, will remain in force for a maximum of 10 years from the first calendar date on which:

1. this Share Option Scheme is approved by the shareholders; and
2. this Share Option Scheme and the granting of the options under it, as well as the listing of the shares to be issued according to this Share Option Scheme and permission to trade such shares have been approved by the HKSE (the "Effective Date").

On September 1, 2001, the amendments to the relevant provisions of the Listing Rules regarding the requirements of share option schemes of a Hong Kong listed company came into effect. A Hong Kong

listed company must comply with the new provisions of the Listing Rules if it wishes to grant any options after September 1, 2001.

The Company has proposed to amend its Share Option Scheme to comply with the new Listing Rules requirements. A circular setting out the changes to the Share Option Scheme will be sent to the shareholders of the Company. The Company intends to hold an extraordinary general meeting at Island Shangri-la Hong Kong, Two Pacific Place, Supreme Court Road, Hong Kong on June 6, 2002 immediately after the conclusion of the annual general meeting to be held on the same date, to consider and, if thought fit, approve the amendments to the Share Option Scheme.

Options which have been granted before September 1, 2001 shall be governed by the rules of the Share Option Scheme adopted on February 4, 2001. The amendments to the Share Option Scheme shall not operate to affect adversely the terms of issue of the options which have been granted prior to September 1, 2001. No further options will be granted under the Share Option Scheme adopted on February 4, 2001.

Under the proposed amended Share Option Scheme, the Directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares. The maximum aggregate number of shares (including those that could be subscribed for under the pre-global offering share option scheme, the particulars of which are described below) which may be granted shall not exceed

Report of the Directors (Cont'd)

10 % of the total issued share capital of the Company. The maximum number of shares which may be granted under the Share Option Scheme to any individual in any 12 month period up to the next grant shall not exceed 1% of the total issued share capital of the Company from time to time.

According to the proposed amended Share Option Scheme, the consideration payable by a participant for the grant of an option is an undertaking to pay HK\$1.0 to the Company. The subscription price of a share payable by a participant upon the exercise of an option will be determined by the Directors at their discretion at the date of grant, except that such price may not be set below a minimum price which is the highest of:

1. the nominal value of a share;
2. the average closing price of the shares on the HKSE as stated in the HKSE's quotation sheets for the five trading days immediately preceding the date of grant of the option; and
3. the closing price of the shares on the HKSE as stated in the HKSE's quotation sheets on the date of grant of the option.

The period during which an option may be exercised is as follows:

1. one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
2. one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
3. one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

As at December 31, 2001, options for ordinary shares which have been granted under the Share Option Scheme were as follows:

Name of Grantee	Position	Date of Grant	Closing Price of Shares		No. of Options
			on August 24, 2001 (HK\$)	Exercise Price (HK\$)	
Wei Lücheng	Chairman & CEO	Aug 27, 2001	7.30	6.16	500,000
Fu Chengyu	Executive Director, President & COO	Aug 27, 2001	7.30	6.16	350,000
Jiang Longsheng	Executive Director	Aug 27, 2001	7.30	6.16	230,000
Zhou Shouwei	Executive Director & Executive Vice President	Aug 27, 2001	7.30	6.16	350,000
Luo Han	Executive Director	Aug 27, 2001	7.30	6.16	230,000
Other Employees		Aug 27, 2001	7.30	6.16	7,160,000

The exercise period shall commence on the date on which the options are accepted in accordance with the terms of the Share Option Scheme and in any event shall end not later than 10 years from the Effective Date.

On February 4, 2001, the Company also adopted a pre-global offering share option scheme (the "Pre-Global Offering Share Option Scheme"), the principal terms of which are the same as the Share Option Scheme in all material respects except that:

1. options for an aggregate of 4,620,000 shares have been granted under the Pre-Global Offering Share Option Scheme;
2. the subscription price per share is HK\$5.95; and
3. the period during which an option may be exercised is as follows:
 - 50% of the shares underlying the

option shall vest 18 months after the date of the grant; and
- 50% of the shares underlying the option shall vest 30 months after the date of the grant.

As at December 31, 2001, options for ordinary shares which have been granted under the Pre-Global Offering Share Option Scheme were as follows:

Name of Grantee	Position	Date of Grant	Exercise Price		No. of Options
			Price (HK\$)	Options	
Wei Lücheng	Chairman & CEO	March 12, 2001	5.95	500,000	
Fu Chengyu	Executive Director, President & COO	March 12, 2001	5.95	350,000	
Jiang Longsheng	Executive Director	March 12, 2001	5.95	280,000	
Zhou Shouwei	Executive Director & Executive Vice President	March 12, 2001	5.95	280,000	
Luo Han	Executive Director	March 12, 2001	5.95	280,000	
Other Employees		March 12, 2001	5.95	2,930,000	

As at December 31, 2001, no options granted under the Share Option Scheme and the Pre-Global Offering Share Option Scheme have been exercised.

The weighted average fair value of the options granted under the Share Option Scheme and the Pre-Global Offering Share Option Scheme at the grant dates was RMB3.10. This was estimated using the Black-Scholes option pricing model under the following assumptions: risk-free interest rates of 5.25%, expected volatility of 44.0%, an expected life of five years and an expected dividend yield of 2.0%.

The assumptions on which the option pricing model is based represent the subjective estimations of the Directors as to the circumstances existing at the time the options were granted.

Purchase, Sale or Redemption of Shares

For the year ended December 31, 2001, neither the Company nor its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

Substantial Shareholder of the Company

As at December 31, 2001, so far as is known to the Directors, the following person was, directly or indirectly, interested in 10% or more of the issued share capital carrying rights to vote at the general meeting of the Company. Such person has no options in respect of such capital:

Name of the person	No. of Ordinary Shares
CNOOC (BVI) Limited	5,800,000,000

Directors and Senior Management of the Company

Please refer to pages 28 to 31 for information concerning the Directors and senior management of the Company.

Directors' Interests in the Equity Securities of the Company

As at December 31, 2001, the interests of the Directors and chief executive of the Company in the equity securities of the Company and its associated companies as required to be recorded in the register maintained under section 29 of the Securities (Disclosure of Interests) Ordinance were as follows:

Director	Company	Personal Interest
Chak Kwong So	CNOOC Limited	30,000 Ordinary Shares

Directors' Interests in Contracts

Each of the Executive Directors has entered into a service contract with the Company for a term of three years effective from February 28, 2001.

Apart from the foregoing, no Director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation (other than statutory compensation).

Save as the service contracts mentioned above, as at December 31, 2001, the Directors of the Company did not have any material interests, whether directly or indirectly, in any contracts of significance entered into by the Company.

Emoluments of the Directors and the Five Highest Paid Individuals

Please refer to note 7 to the financial statements on pages 55 to 56 for details of the emoluments of the Directors and the five highest paid individuals of the Company.

Material Legal Proceedings

As at December 31, 2001, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company as far as the Company is aware of.

Compliance with the Code of Best Practice

The Company has complied with the Code of Best Practice as set out by the HKSE in Appendix 14 to the Listing Rules

throughout the year ended December 31, 2001, except that the Non-executive Directors were not appointed for a specific term, but are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's articles of association.

Auditors

Arthur Andersen & Co was appointed as the auditors of the Company for the year ended December 31, 2001 and has audited the accompanying financial statements.

By Order of the Board

Liucheng WEI
Chairman

Hong Kong, March 27, 2002