

REPORT OF THE DIRECTORS

The directors present their first report and the audited financial statements of the Company and the Group for the year ended 31 December 2002.

Group Reorganisation and Basis of Presentation

The Company was established on 25 December 2001 by China National Offshore Oil Corporation (“CNOOC”), a State-owned enterprise in the People’s Republic of China (the “PRC”), in Tianjin, the PRC, as a limited liability company under the Company Laws of the PRC. As part of the reorganisation (the “Reorganisation”) of CNOOC in preparation for the listing of the Company’s shares on The Stock Exchange of Hong Kong Limited (the “HKSE”) and pursuant to an approval document obtained from the relevant government authority on 26 September 2002, the Company was restructured into a joint stock limited liability company. Pursuant to the Reorganisation which was effective on 30 April 2002, the Company acquired from the wholly-owned subsidiaries of CNOOC certain businesses and interests in certain companies. Further details of the Reorganisation, together with the details of the businesses and equity interests in certain companies acquired pursuant thereto, are set out in note 1 to the financial statements and in the prospectus of the Company dated 11 November 2002 (the “Prospectus”).

The shares of the Company were listed on the HKSE on 20 November 2002.

Principal Activities

The Company is principally engaged in the provision of oilfield services including drilling services, well services, marine support and transportation services, and geophysical services offshore China. The principal activity of the subsidiary comprises sale of logging equipment. There were no significant changes in the nature of the Group’s principal activities during the year.

Results and Dividends

The Group’s profit for the year ended 31 December 2002 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 46 to 88.

An interim profit distribution of RMB344,921,000 was made and distributed to CNOOC prior to the Reorganisation (see basis of presentation in note 1 to the financial statements) in 2002. The directors recommend the payment of a final dividend of RMB1.31 cents per share in respect of the year, to shareholders on the register of members on 24 April 2003. This recommendation has been incorporated in the financial statements as an allocation of retained earnings within capital and reserves in the balance sheet. Further details of this accounting treatment are set out in note 14 to the financial statements.

Use of Proceeds from the Company’s Initial Public Offering and Placement of New Shares

The proceeds from the initial public offering, after netting off related expenses paid and payable, were RMB2,372 million. As of 31 December 2002, USD15,000,000 (equivalent to approximately RMB124 million) was utilized for the repayment of a loan for vessel construction. The un-utilised proceeds were mostly deposited in interest-bearing accounts in HKD and USD with well-known commercial banks in the PRC as at 31 December 2002. The intended use of proceeds as set out in the Company’s Prospectus from its global offering and placement in November 2002, remains unchanged.

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Summary Financial Information

A summary of the published pro forma combined results and the assets and liabilities of the Group prepared on the basis set out in the notes below is as follows:

Results

	Year ended 31 December			
	1999 RMB'000	2000 RMB'000	2001 RMB'000	2002 RMB'000
	(note)	(note)	(note)	(note)
Turnover	1,662,031	2,178,449	2,365,566	2,725,782
Other revenues	1,556	3,196	20,996	4,600
Operating expenses				
Depreciation of property, plant and equipment	(388,291)	(377,894)	(383,037)	(552,523)
Employee compensation costs	(237,705)	(309,791)	(455,480)	(462,293)
Repair and maintenance costs	(207,337)	(246,230)	(235,003)	(152,693)
Consumption of supplies, materials, fuel, services and others	(611,023)	(719,617)	(793,213)	(836,460)
Other operating expenses	(99,538)	(109,655)	(110,336)	(200,916)
Other selling, general and administrative expenses	(33,632)	(22,765)	(21,903)	(42,475)
Provision for impairment of long term investments	(12,023)	—	—	—
Provision for impairment of property, plant and equipment	—	(30,800)	(38,000)	—
Total operating expenses	(1,589,549)	(1,816,752)	(2,036,972)	(2,247,360)
Profit from operations	74,038	364,893	349,590	483,022
Finance costs				
Exchange losses, net	(468)	277	(561)	(973)
Interest expenses	(2,390)	(6,340)	(9,373)	(5,289)
Interest income	19,535	30,505	28,125	11,216
	16,677	24,442	18,191	4,954
Share of profits of jointly-controlled entities	24,242	30,961	47,837	42,600
Share of loss of an associate	—	(33,781)	(3,434)	—
Profit before tax	114,957	386,515	412,184	530,576
Tax	(26,750)	(99,659)	(139,106)	(176,190)
Net profit from ordinary activities attributable to shareholders	88,207	286,856	273,078	354,386

Summary Financial Information *continued*

Assets and Liabilities

	31 December			
	1999	2000	2001	2002
	RMB'000	RMB'000	RMB'000	RMB'000
	(note)	(note)	(note)	
Total Assets	4,074,938	4,518,434	5,030,062	7,957,532
Total Liabilities	(1,369,208)	(1,793,992)	(2,095,057)	(1,776,937)
	2,705,730	2,724,442	2,935,005	6,180,595

- Notes:*
1. The results of the Group for each of the three years ended 31 December 2001, and assets and liabilities as at 31 December 1999, 2000 and 2001 presented above have been extracted from the Company's Prospectus dated 11 November 2002 when the listing of the Company's shares was sought on the HKSE.
 2. The results of the Group for the year ended 31 December 2002, and assets and liabilities of the Group as at 31 December 2002 presented above have been extracted from the pro forma combined profit and loss account and consolidated balance sheet as set out on pages 46 and 47 of the financial statements, respectively.
 3. The results of the Group for each of the four years ended 31 December 2002 and the assets and liabilities of the Group as at 31 December 2001, 2000 and 1999 have been prepared on a pro forma combined basis as if the current Group structure had been in existence since 1 January 1999.

Property, Plant and Equipment

Details of movements in the property, plant and equipment of the Company and the Group during the year are set out in note 16 to the financial statements.

Share Capital

Details of movements in the Company's share capital during the year, together with the reasons therefor, are set out in note 29 to the financial statements.

Pre-emptive Rights

There are no provisions for pre-emptive rights under the Company's articles of association or the Company Law of the PRC which oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Purchase, Redemption or Sale of Listed Securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 30 to the financial statements and in the consolidated statement of changes in equity and pro forma statement of changes in equity (see basis of presentation in note 1 to the financial statements), respectively.

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Distributable Reserves

At 31 December 2002, in accordance with the PRC Company Law, an amount of approximately RMB1,976 million standing to the credit of the Company's capital reserve account and an amount of approximately RMB31 million standing to the credit of the Company's statutory reserve funds (details of which are set forth in note 30 to the financial statements), as determined under the PRC accounting standards and regulations, were available for distribution by way of future capitalization issue. In addition, as set forth in note 30 to the financial statements, the Company had retained profits of approximately RMB124 million available for distribution as dividends.

Save as aforesaid, the Company did not have any reserves available for distribution to its shareholders at 31 December 2002.

Charitable Contributions

During the year, the Group made charitable contributions totalling RMB64,000.

Major Customers and Suppliers

In the year under review, sales to the Group's five largest customers accounted for 62% of the total sales for the year and sales to the largest customer included therein amounted to 47%. Purchases from the Group's five largest suppliers accounted for 28% of the total purchases for the year.

The Group has provided certain oilfield services to and obtained certain services from the companies with the same ultimate holding company of the Company, details of which are set forth in the note "Connected Transactions" below. Save as aforesaid, none of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers and five largest suppliers.

Directors and Supervisors

The directors and supervisors of the Company during the year were:

Executive Directors:

Fu Chengyu	(appointed on 20 September 2002)
Yuan Guangyu	(appointed on 20 September 2002)
Yang Yexin	(appointed on 20 September 2002)

Non-executive Director:

Wang Zhongan	(appointed on 20 September 2002)
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Independent Non-executive Directors:

Gordon Che Keung Kwong	(appointed on 30 October 2002)
Richard Paul Margolis	(appointed on 20 September 2002)
Andrew Y. Yan	(appointed on 20 September 2002)

Supervisors:

Liu Shoude	(appointed on 20 September 2002)
Tu Zhimin	(appointed on 20 September 2002)
Zhang Benchun	(appointed on 20 September 2002)

Subsequent to the balance sheet date, on 28 February 2003, Richard Paul Margolis resigned as a director of the Company.

In accordance with the Company's articles of association, all directors and supervisors are elected to a term of three years and may serve consecutive terms upon re-election.

Directors', Supervisors' and Senior Management's Biographies

Biographical details of the directors and supervisors of the Company and the senior management of the Group are set out on pages 34 to 36 of the Annual Report.

Directors' and Supervisors' Service Contracts

Each of the independent non-executive directors is required to enter into a service contract with the Company for a term of three years, renewable upon re-election.

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.

Directors' and Supervisors' Interests in Contracts

None of the directors and supervisors had a material interest, either direct or indirect, in any contract of significance to the business of the Group to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party during the year.

Contracts of Significance

The Company has entered into several agreements with CNOOC Limited, a fellow subsidiary of the Company, and CNOOC Group other than CNOOC Limited, for the provision of oilfield services by the Company to CNOOC Limited and CNOOC Group, and for the provision of various services by CNOOC Group to the Company. Further details of the transactions undertaken in connection with these contracts during the year are included in note 36 to the financial statements.

Directors' and Supervisors' Interests in Shares

As at 31 December 2002, none of the directors, supervisors, or their associates had any personal, family, corporate or other interests in any equity or debt securities of the Company or any of its associated corporations as defined in the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance").

Directors' and Supervisors' Rights to Acquire Shares or Debentures

At no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any director, supervisors or their respective spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

Substantial Shareholders

At 31 December 2002, CNOOC held 2,460,468,000 State legal person shares representing 61.58% of the issued share capital of the Company recorded in the register of interests required to be kept by the Company pursuant to Section 16(1) of the SDI Ordinance.

Save as disclosed above, no person had registered an interest in the share capital of the Company that was required to be recorded pursuant to Section 16(1) of the SDI Ordinance.

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Connected Transactions

Upon the listing of the H Shares of the Company on the HKSE on 20 November 2002, transactions between the Group and its connected persons or their respective associates (as the respective terms are defined by the HKSE Listing Rules) are governed by and are required to comply with the requirements of the HKSE Listing Rules. During the year ended 31 December 2002, the Group had the following connected transactions:

	Pro forma combined for the year ended 31 December 2002 RMB'000 (note)
A. Gross revenue earned from provision of services to the following related parties:	
a. CNOOC Limited Group	
Provision of drilling services	480,744
Provision of well services	332,658
Provision of marine support and transportation services	299,736
Provision of geophysical services	153,136
	1,266,274
b. CNOOC Limited Group as operator under production sharing contracts	
Provision of drilling services	62,136
Provision of well services	194,649
Provision of marine support and transportation services	57,983
Provision of geophysical services	16,980
	331,748
c. CNOOC Group (including services provided by China Nanhai-Magcobar Mud Corporation Ltd. ("Magcobar"))	
Provision of drilling services	5,828
Provision of well services	31,743
Provision of marine support and transportation services	91,711
Provision of geophysical services	10,092
	139,374
d. Jointly-controlled entities	
Provision of drilling services	2,449
Provision of well services	22,845
	25,294

Connected Transactions *continued*

	Pro forma combined for the year ended 31 December 2002 RMB'000
	(note)
B. Included in operating expenses (including services provided to Magcobar)	
Services provided by the CNOOC Group:	
Labour services	52,175
Materials, utilities and other ancillary	67,617
Transportation services	9,500
Lease of office, warehouse, berths	8,149
Lease of equipment	1,420
Repair and maintenance services	27,724
Management services	4,375
	170,960
C. Deposits placed with CNOOC Finance Company at 31 December 2002	73,321
D. Interest income earned from deposits placed with CNOOC Finance Company	56
E. Deposits and loans:	
Deposits placed with CNOOC Trust Company at 31 December 2002	24,230
Advance made by CNOOC during the year and repaid prior to 31 December 2002	238,000
F. Included in interest income/expenses:	
Interest income earned from deposits placed with the CNOOC Group	1,805
Interest expense paid to the CNOOC Group	4,520
G. Transfer of property, plant and equipment (including property, plant and equipment purchased by Magcobar):	
Purchases of property, plant and equipment from the CNOOC Group	4,463
Sale of property, plant and equipment to the CNOOC Group	98,553

Note: See basis of presentation in note 1 to the financial statements.

For items (A) to (D) above, a waiver has been granted by the HKSE to the Company from strict compliance with the requirements of the connected transaction rules of the HKSE Listing Rules in respect of the connected transactions set out above.

Items (E) to (G) above were not covered by the waiver as explained above.

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Connected Transactions *continued*

The independent non-executive directors have reviewed the above transactions and have confirmed that:

1. the transactions were entered into between the Group and the connected persons or their respective associates (where applicable) in the ordinary and usual course of its business;
2. the transactions were entered into on normal commercial terms, or where there is no available comparison, on terms no less favourable than those available from or to independent third parties;
3. the transactions were entered into in accordance with the relevant agreements governing such transactions, on terms that are fair and reasonable to the independent shareholders as a whole; and
4. the transactions were entered into with the annual aggregate value of each category of connected transactions not exceeding the relevant annual limits as agreed with the HKSE.

Code of Best Practice

In the opinion of the directors, the Company complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of the HKSE, throughout the accounting period covered by the annual report.

Audit Committee

The final results have been reviewed by the audit committee of the Board which consists of two independent non-executive Directors. The committee has reviewed the accounting principles and practices adopted by the Company, and has also discussed auditing, internal control and financial reporting matters including the review of audited 2002 annual results with the management. Since the listing of the Company's shares on 20 November 2002, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of the HKSE.

Auditors

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

ON BEHALF OF THE BOARD

Fu Chengyu

Chairman

Hong Kong
2 April 2003