Management Discussion & Analysis

Industry Review

2003 was a tumultuous year in international politics. But for the global oil industry, it was an unconventional year. Oil prices fluctuated throughout 2003 and stood high at an average of US$30.34/barrel largely as a result of the oil industry strike in Venezuela and political unrest in Iraq.

In terms of crude oil demand, a report published by the International Energy Agency (IEA) indicated that world crude oil consumption in 2003 was approximately 78.46 million barrels/day, an increase of 1.9% compared to 2002. USA, which consumes approximately one fourth crude oil in the world, experienced an increase in heating oil consumption during the first quarter and domestic natural gas in the USA averaged US$5.29/$m^3$. Imports of crude oil by the USA increased. In Japan, 17 nuclear plants were shut down (five of which have come back into operation), which led to a surge in demand for crude oil. In China, economic growth managed to record an impressive 9.1% growth, which added further demand for crude oil. According to the IEA, China has surpassed Japan to become the second largest consumer of oil in the world at 5.76 million barrels/day, or 7.1% of total world consumption. China imported a total of 91.12 million tons of crude oil in 2003, increasing by 31.3% compared to 2002. This rise of demand in China was primarily due to a surge in demand for electricity and increase in automobile ownership.

In terms of global crude oil supply, average crude oil production was approximately 82.10 million barrels/day, an increase of 4% compared to 2002. OPEC accounted for an average of 25.8 million barrels/day, which represented an over-production of 1.3 million barrels/day, but 145,000 barrels less than the average daily production in 2002. In 2003, production increases from non-OPEC countries, especially Russia, North Sea in United Kingdom and Brazil had in a way offset a production decline from OPEC countries. As such, there was basically a balance in overall global oil supply.

Riding on higher global demand for oil and gas, higher oil prices and increased exploration, development and production activities from oil and gas companies, 2003 was a year of progress for the global oilfield services industry, shaking off uncertain prospects from 2002.

As the dominant integrated oilfield services provider in the offshore China market, COSL's performance was most influenced by exploration and development activities offshore China. According to public information released by CNOOC Limited (0883.HK), capital expenditure in exploration and development in the offshore China market recorded a CAGR of 20.7% between 1997 and 2002 and the capital expenditure in exploration activity grew at a CAGR of 22.7%. COSL benefited from this continued growth of exploration and development activities offshore China, which led to a strong and steady growth in all areas of our business. The number of exploration wells we drilled remained the same as 2002 at 57, while the number of development wells we drilled surged to 139, representing an increase of 73 wells over 2002.

Apart from drilling services, COSL offers a full range of other oilfield services, including well services, marine support and transportation services as well as geophysical services, spanning each phase of the exploration, development and production process. In line with our long-term development strategies, we will continue to synergize and integrate our services so as to provide, efficient, cost effective and professional services to our customers.

Business Review

Drilling Services

We are the dominant provider of drilling services in the offshore China market. We also provide well workover services to our customers in connection with our production related drilling services. As of December 31, 2003, we owned 12 drilling rigs and operated one additional rig as a dry-lease. Seven out of our 13 drilling rigs operated in the Bohai Bay. Three drilling rigs were deployed in South China Sea, two of which were semi-submersibles. Another semi-submersible operated in East China Sea, while one of our jack-up rigs was assigned to offshore Jakarta, Indonesia. The jack-up drilling rig we leased in November 2003 was subject to renovation and did not come into service until early 2004.

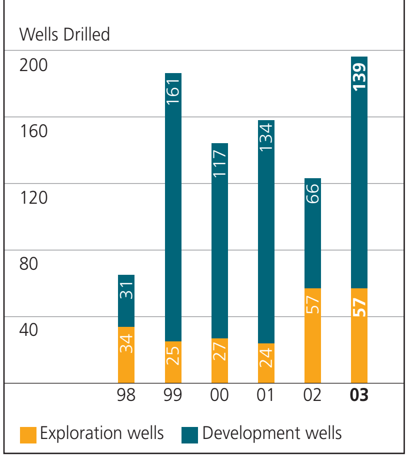
We mainly work under two types of drilling contracts. The first type is called well-by-well contracts, which covers one or more independent wells based on fixed day rates. Most of our drilling contracts fall into this category. The other type is IPM contracts, which typically provides a lump sum payment for drilling and related oilfield services for a specified number of wells.

In 2003, demand for our drilling services remained strong. We drilled a total of 196 wells in 2003 (including 25 wells currently under development). The number of exploration wells we drilled remained the same as 2002 at 57 wells (including six wells in overseas projects), while the number of development wells we drilled surged to 139 wells (including 19 wells in overseas projects), compared to 66 wells in 2002.

Benefitting from high exploration and development activities offshore China, demand for our drilling rigs, especially for our jack-up rigs remained strong. In 2003, our drilling rigs operated for a total of 3,525 days, an increase of 298 days compared to 2002. Operating days for our jack-up rigs increased by 466 days over 2002 while our semi-submersibles operated 168 days less compared to 2002. Preparation days fell by 363 to 345 days in 2003, compared to 708 days in 2002, resulting in an increase in the number of days available for operation. This increase, together with a decrease in operating days for our semi-submersibles, led to a decline in the overall utilization rate, from 87.9% in 2002 to 87.4% in 2003. The average utilization rate for our jack-up rigs increased from 86.4% in 2002 to 94.1% in 2003, while the average utilization rate for our semi-submersibles decreased from 93.1% in 2002 to 65.0% in 2003. Overall day rates we charged went up by 5.5% in 2003. Average day rate for our jack-up rigs increased by 8.2% from US$29,102/day in 2002 to US$31,501/day in 2003. Average day rate for our semi-submersibles increased by 11.6% from US$44,910/day in 2002 to US$50,115/day in 2003.

Together with our drilling services expansion, our production platform well workover services picked up momentum. In 2003 we completed well workover jobs of 6,600 days/team, or 828 wells, an increase from the 4,820 days/team or 815 wells in 2002. In 2003, we performed well workover services in Liaodong Bay, Suizhong 361, Boxi and Bonan blocks, and had successfully reduced the conventional pump recovery cycle from 11 days to 7.84 days. On the other hand, we entered into a production platform well workover service agreement with ConocoPhillips China in September 2003 for the development of the Peng Lai 19-3 block. The three-year contract calls for COSL to build a well workover rig for the block, and to provide well workover services to this production sharing company.

Wells Drilled by COSL

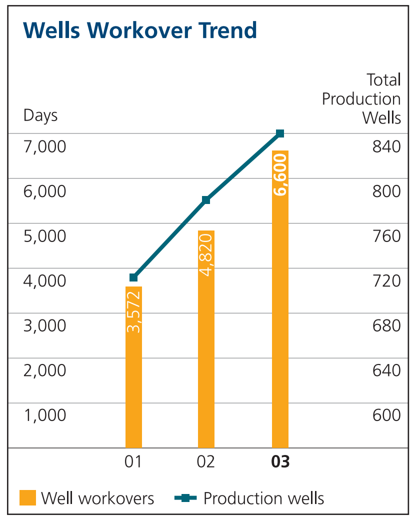


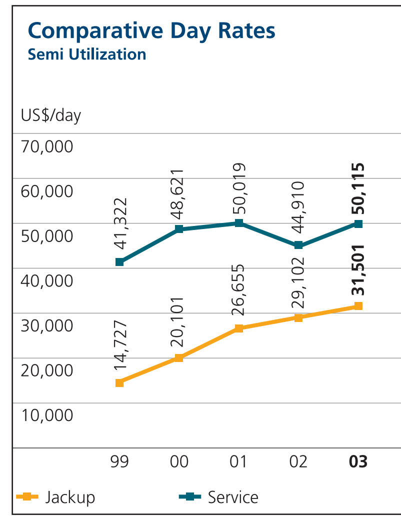
Drilling Services

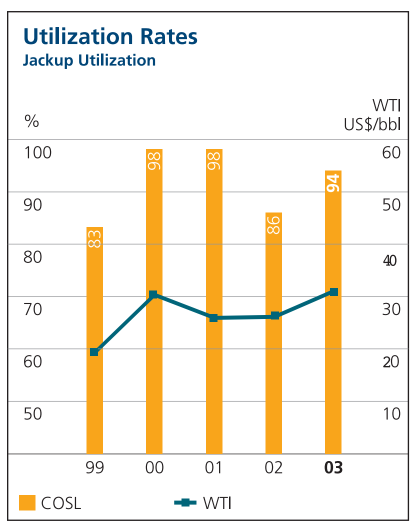
Spirit of Our Culture Valuing Human Asset and Innovation

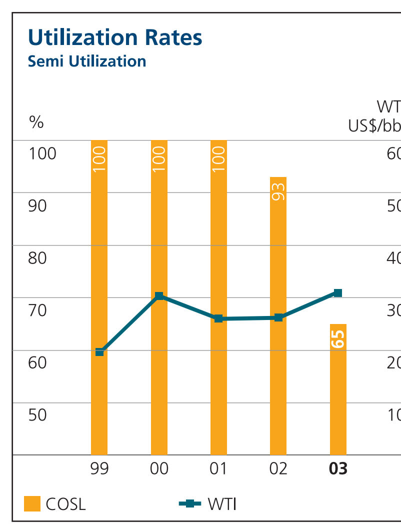
Management Discussion & Analysis

During the year, our drilling rigs performed most drilling operations in the Bohai Bay, Western South China Sea, Eastern South China Sea and East China Sea. Bohai 4 provided drilling services offshore Indonesia. Bohai 9 completed its drilling assignment offshore West Africa and began working on a new drilling assignment in the Bohai Bay area in December 2003.









In April 2003, with a view to satisfying the ongoing market demand for drilling services, COSL initiated its construction program to build a new jack-up rig that can drill in water depths of up to 400 feet. As of the end of the year, we were reviewing bids from potential construction shipyards. On March 29, 2004, we signed the construction contract with Dalian New Ship Building Heavy Industries Co., Ltd to build the jack-up rig for a total contract price of RMB450 million, including the installation, but excluding the purchase, of the relevant drilling-related systems and equipment. In addition, COSL dry-leased a jack-up rig in November 2003. Built in 1976, the jack-up rig has legs of 127.2 meters long, and is capable of drilling depths of up to 6,000 meters. The charter contract has a duration of eight years, (includes periods of renovating and upgrading). The rig was transported to Dalian City in November 2003 as provided in the agreement, and was deployed in early 2004 for drilling exploratoin wells in the Bohai Bay area following a preliminary upgrade.

List of 2003 Rig Assignments

Rig	Contract	Operator	Drilling Start Day	Wells	Location
BH 4	Drilling	CNOOC SES	2003-1-18	25	Indonesia Sea
BH 5	Drilling	CNOOC	2003-1-17	6	Bohai Bay
BH 5	Drilling	CNOOC	2003-6-26	34	Bohai Bay
BH 7	Drilling	KERR-McGEE	2003-2-4	11	Bohai Bay
BH 7	Drilling	CNOOC	2003-10-18	8	Bohai Bay
BH 8	Drilling (IPM)	PHILLIPS	2003-1-20	2	Bohai Bay
BH 8	Drilling	CNOOC	2003-4-9	2	Bohai Bay
BH 8	Drilling	CNOOC	2003-5-8	17	Bohai Bay
BH 8	Drilling	KERR-McGEE	2003-11-14	6	Bohai Bay
BH 9	Drilling	AMNI	STANDBY	0	Nigeria
BH 9	Drilling	CNOOC	2003-12-28	1	Bohai Bay
BH 10	Drilling	CNOOC	2003-2-17	7	Bohai Bay
BH 10	Drilling	KERR-McGEE	2003-5-5	1	Bohai Bay
BH 12	Drilling	CNOOC	2003-2-14	4	Bohai Bay
BH 12	Drilling	CNOOC	2003-5-25	17	Bohai Bay
NH 1	Drilling	PHILLIPS	2003-1-27	13	Bohai Bay
NH 1	Drilling	CNOOC	2003-11-3	5	Bohai Bay
NH 2	Drilling	HUSKY	2003-1-4	2	South China Sea (W)
NH 2	Drilling	CNOOC	2003-3-1	3	South China Sea (E)
NH 2	Drilling	CNOOC	2003-7-27	1	South China Sea (W)
NH 2	Drilling	CNOOC	2003-12-24	1	South China Sea (W)
NH 4	Drilling	CNOOC	2003-2-7	17	South China Sea (W)
NH 5	Drilling	CNOOC	2003-2-10	5	South China Sea (E)
NH 5	Drilling	TCPOC	2003-9-26	1	South China Sea (E)
NH 5	Drilling	CNOOC	2003-12-22	1	East China Sea
NH 6	Drilling	DEVON	2003-2-2	1	South China Sea (E)
NH 6	Drilling	SHELL	2003-2-24	1	South China Sea (E)
NH 6	Drilling	CNOOC	2003-10-8	2	South China Sea (W)
NH 6	Drilling	CNOOC	2003-12-4	2	South China Sea (W)
				Total 196	

Well Services

Guidelines for Our Employees, Integrity, Professionalism, Coordination

Management Discussion & Analysis

Well Services

We provide a full range of well services to exploration and production companies operating offshore China in addition to certain onshore projects. The well services we offer include wire-line logging, drilling fluids, directional drilling, cementing and downhole services and data totalization services (DTS).

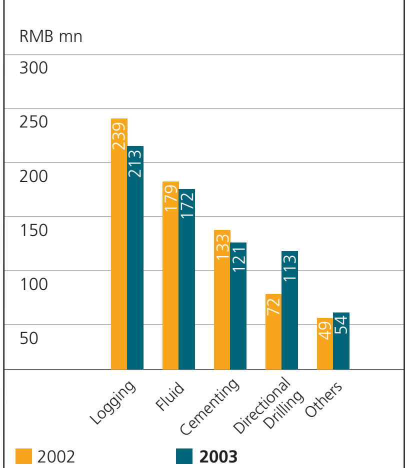
Logging

We provide onshore and offshore logging services for open-hole, cased hole production wells, including on-site logging data collection and processing. These services include tubing-conveyed perforation (TCP) and well engineering services. In 2003, we successfully promoted new logging technologies to our customers, such as dual TCP and reservoir regulation. We conducted 433 logging trips throughout the year, compared to 536 trips in 2002. Turnover from logging services decreased by 12.2% from RMB239 million in 2002 to RMB213 million in 2003. This decrease was mainly due to fewer exploration activities by our customers (37 wells in 2003; 43 wells in 2002), and their strategic adjustments resulting in reduction single-well logging trips and volume.

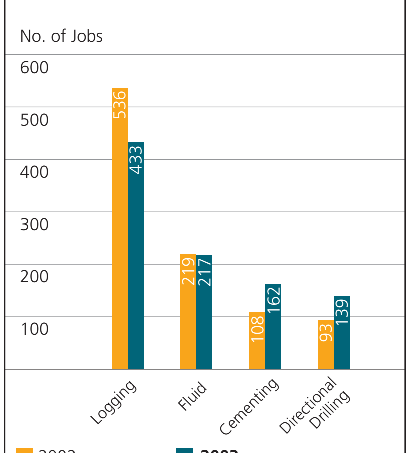
Drilling Fluids

We offer drilling fluids services in conjunction with our drilling services, which include technical fluids services, sales of drilling fluids materials and rental of drilling fluids equipment. The offshore China market has evolved to using oil-based mud and high performance clog reduction fluids. We provided drilling fluids services to a total of 217 wells in 2003 in our drilling, well completion and well workover services, slightly decreasing from the 219 wells in 2002. Turnover generated from these services amounted to RMB172 million and RMB179 million, respectively, in 2003 and 2002.

Well Services Revenue Breakdown



Well Services Job Breakdown



Cementing

We specially designed our cement slurries to match various well specifications, such as density, thickening time and compression strength. We also provide cement lab testing, additives and other related services to our customers. In 2003, we offered new technologies including low-density high strength cement slurries and enhanced latex system for development wells in the Bohai Bay and exploration wells in the South China Sea. These new technologies were well received by our customers. In 2003, we completed cementing services on 162 wells, representing an increase of 54 wells compared to 2002. The increase was primarily due to an increase in the development wells subject to such service during the year. Turnover generated from cementing services in 2003 and 2002 were RMB121.0 million and RMB133.0 million, respectively. Cementing turnover declined by 9% compared to 2002 mainly because we did not perform cementing jobs for higher priced HTHP wells, as we did to two HTHP wells in 2002 (Rates we charge for cementing services performed on an HTHP well are usually higher than the rates we charge for cementing services performed on a normal well).

Directional Drilling

We offer a complete line of directional drilling services, including directional, horizontal, slim hole directional and cluster well drilling. We performed directional drilling on 139 wells, an increase of 46 wells compared to 2002. Turnover from directional drilling services in 2003 and 2002 amounted to RMB113.0 million and RMB72.0 million, respectively. This 56.9% increase was mainly due to a large increase in the number of development wells we drilled compared to 2002. Another reason for the boost in turnover was attributable to our use of additional LWD tools and high end directional rotating and steering tools.

Other Well Services

We offer other well services, including downhole drilling and Data Totalization Services (DTS) to our customers.

Downhole services are associated with well completion, well workover and production enhancement. This service typically revolves around servicing pipelines, filtering drilling fluids, sand control, acidization, wireline technology services, Navi pump operation, and coring and downhole tools servicing.

DTS serves as a real-time data transmission platform between the front line operation system and the back office strategic system. It puts together technical solutions, including data totalization, transmission and release, for oil exploration and development activities (such as drilling, geophysical surveying, gas surveying, drilling fluids, cementing, logging and directional drilling). It also provides comprehensive data processing and analysis and is as an accurate data source for information collected during drilling activities.

In 2003, turnover generated from other well services amounted to RMB54.0 million, representing a 10.2% increase as compared to RMB49.0 million in 2002. This increase was primarily attributable to a higher volume of downhole service activities.

Marine Support and Transportation Services

We own and operate the largest and most diverse marine support and transportation fleet offshore China. As of December 31, 2003, COSL owned and operated 58 marine support vessels and five oil tankers. The fleet operates in the offshore China market as well as in other markets. Our marine support fleet supports offshore oil and gas exploration, development and production by transporting materials, supplies and personnel to and from offshore facilities, move and position drilling structures as well as handle anchor and towing. Our oil tankers transport crude oil and refined petroleum products. As of December 31, 2003, 32 out of our 58 marine support vessels operated in the Bohai Bay area, 21 were deployed in South China Sea, four provided services in East China Sea and one was under repair. All five oil tankers operated in the Bohai Bay area.

COSL added a total of five newly built vessels to its fleet in the respective months of February, April, June, October and November in 2003. We had originally intended to put all seven newly built vessels into operation by the end of 2003. However, delivery by the shipyard in which Nanhai 221 and Nanhai 287 were built was delayed until 2004. Nanhai 221 has been in operation since January 2004, while Nanhai 287 started operation in March, 2004. As such, our marine support fleet consisted of 58 vessels as of the end of 2003. Due to the expansion of our fleet and a decrease in vessel repair days, total days of availability, total days of operation and average utilization rate increased in 2003. Total days of availability increased from 19,100 days in 2002 to 19,471 days in 2003. Total days of operation increased from 18,117 days in 2002 to 18,803 days in 2003. The average utilization rate for our marine support vessels reached 96.6%, compared to 94.8% in 2002. As a number of oilfields decreased their production in 2003, transportation volume of our oil tankers fell by 5.4%, from 1,228,274 tons in 2002 to 1,162,327 tons in 2003.

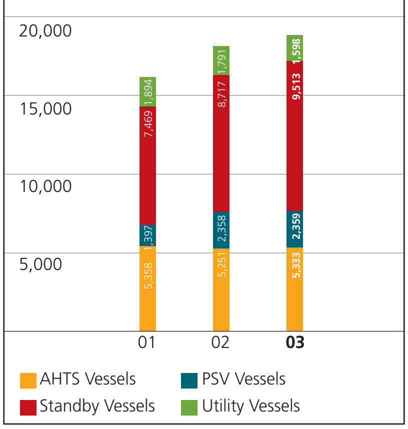
In 2003, we disposed of one of our utility vessels, Binhai 219 and one of our tankers, Binhai 601, as they had difficulties in keeping up with current transportation needs due to aging. Binhai 219 and Binhai 601 were built in 1981 and 1979, respectively. We believe the disposal of the two vessels will not have a material adverse effect on COSL's business operation.

Marine Support and Transportation Services

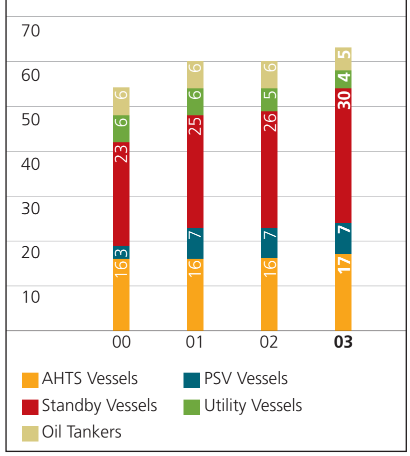
Spirit of Our Culture
Dedicated to Perfection

Management Discussion & Analysis

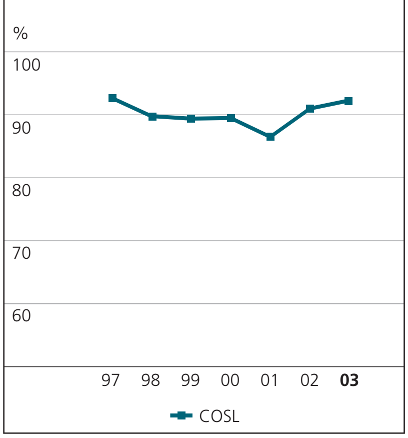
Total Number of Operating Days



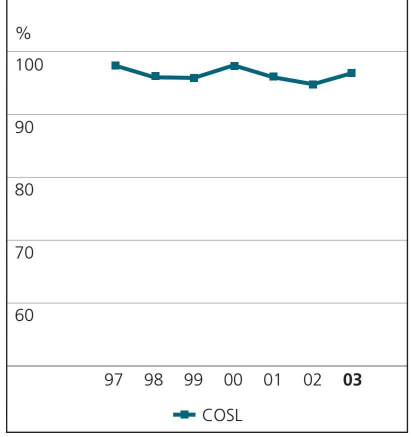
Total Number of Fleet



Calendar Day Utilization Rate



Availability Utilization Rate



We continued to look out for opportunities in the global markets throughout 2003. Both deployed in the offshore Korea region near Pusan, Binhai 283 operated abroad for over four months starting from January 2003, while Binhai 291 operated abroad for two months starting from June 2003.

Geophysical Services

We are the leading provider of geophysical services offshore China. We also provide seismic and survey services in regions such as North and South America, the Middle East, Africa and Europe. Our geophysical services are divided into two categories: seismic services and surveying services.

Seismic Services

We own and operate a fleet of six seismic vessels that provide seismic and offshore seismic data collection services. Our seismic fleet is equipped with modern seismic and navigational equipment, and is capable of gathering both 2D and 3D high resolution seismic data. Four of our seismic vessels mainly perform 2D seismic data collection, and have an annual seismic data collection

Key Specification
for each of the newly build vessels delivered in 2003:

Vessel	Type	Length (Feet)	BHP	kW	DWT
BH286	AHTS	230	8,160	6,000	1,944
NH220	Standby	227	6,908	5,080	1,890
BH266	Standby	228	6,800	5,000	1,767
BH267	Standby	228	6,800	5,000	1,767
BH268	Standby	228	6,800	5,000	1,767

capacity of 500,000 km. The other two of our seismic vessels mainly perform 3D seismic data collection, and have an annual seismic collection capacity of 3,000km^2. We also own a central processing center, which has the capacity to process 400,000 km of 2D and 4,000 km^2 of 3D seismic data per year. The central processing center is located in Tianjin and has a large database of seismic data collected from offshore China.

Seismic services recorded strong growth in 2003. We collected 46,737 km and 2,339 km^2 of 2D and 3D seismic data, respectively. 2D seismic data collection fell by 3.5%, from 48,222 km in 2002. 3D seismic data collection, on the other hand, climbed 24.7%, from 1,875 km^2 in 2002. We also processed 10,944 km of 2D seismic data and 1,828 km^2 of 3D data in 2003. 2D seismic data processing activities slipped 32.6% from 16,244 km in 2002, while 3D seismic data processing activities recorded a decrease of 2.1% from 1,867 km^2 in 2002. The significant increase in revenue from geophysical services in 2003 corresponded to an increase in domestic demand and price increase for our 3D seismic services. Another factor for the growth was attributable to the rise in seismic data sales in the Gulf of Mexico.

During 2003, two of our six seismic vessels operated overseas for the entire 12 months. Nanhai 502 performed services offshore West Africa and Binhai 512 in the Gulf of Mexico. Both seismic vessels were engaged in 2D seismic data collection.

Surveying Services

We own and operate a fleet of three marine geotech survey vessels and provide survey services offshore China. We also own three light-weight drilling rigs and 24 large-scale construction equipment to perform onshore geotechnical investigation and platform foundation construction services.

We offer a variety of geotech survey services, including seabed topographical surveying, offshore construction appraisal, cable and pipeline surveying, geo-hazard analysis, soil sampling and analysis as well as drilling rig leg damage analysis. We also offer foundation analysis of platforms, pipelines, bridges, docks and other constructions, onshore seismic services, oceanographic appraisals, data processing, interpretation and reporting, along with a broad range of geophysics-related consultation services. In 2003, our geotech survey activities were comparable to those in 2002.

Integrated Project Management

We offer oil and gas exploration and production companies an Integrated Project Management (IPM), program. We tailor our services and products to special needs of our customers, capable of covering the entire life of an oil and natural gas field from discovery to abandonment. The program aims at sketching a systematic design, operation and project management services for our customers through our professional and extensive experience in oilfield services, in areas ranging from geophysical, reservoir, drilling, downhole services, to areas in oilfield construction, production and information technology. Our turnkey contracts are entered into as part of our IPM program. In 2003, with a view to meeting market expectations and to providing better services to our clients, we bundled our services into turnkey projects. Such approach allowed us to offer a more comprehensive package of technical services to our customers, which not only helps us to satisfy customer needs, but also to increase our overall income. Although the IPM program may increase our costs, we believe that the program is in line with our overall development plans as it may become a higher margin business if property managed. In 2003, we entered into nine contracts under our IPM program, a net addition of five contracts compared to 2002. Among them is the contract with Kerr-McGee China Petroleum Ltd. for the CFD 11-1/2 oilfield of the Caofeidian 04/36 Block in the Bohai Bay. The services contract is drilling based, and includes cementing, drilling fluids, directional drilling, sand-prevention, perforation, logging-while-drilling and other related services. Another example relates to our turnkey drilling contract with Sinopec Shengli Oilfield. After we completed the

Geophysical Services

Core Values of Our Company

Maximizing Benefits to Shareholders, Customers and Employees

Management Discussion & Analysis

drilling turnkey contract, we entered into another turnkey contract related to well completion and downhole services with Sinopec Shengli Oilfield's for the CB32A block in 2003.

In 2003, our Integrated Project Management contributed RMB437 million, or 14% to our total turnover, a 5% increase as compared with the 9% contribution in 2002.

Financial Review

Turnover

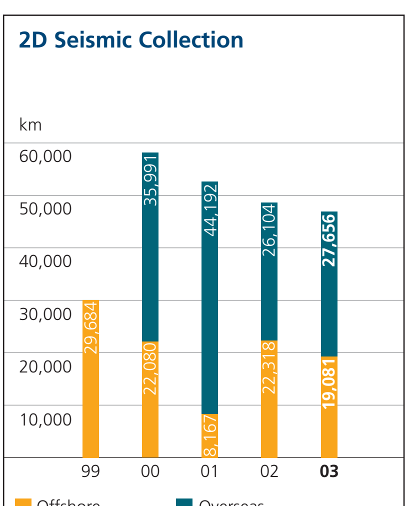
Turnover in 2003 increased by RMB336.5 million or 12.3%, from RMB2,725.8 million in 2002 to RMB3,062.3 million in 2003. The increase in turnover was attributable to a substantial increase in turnover from drilling services and geophysical services, as well as a moderate increase in turnover from marine support and transportation services.

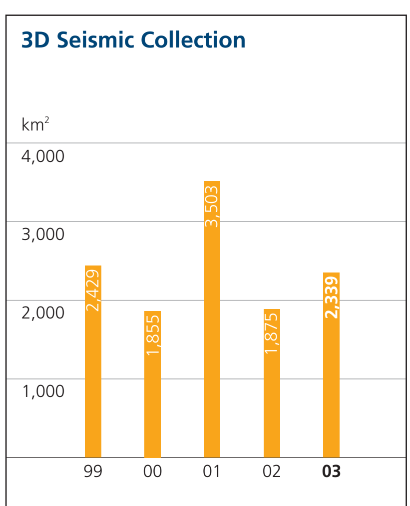
Turnover from drilling services increased by RMB218.1 million, or 20.5%, from RMB1,064.4 million in 2002 to RMB1,282.5 million in 2003, accounting for 41.9% of our total turnover. This increase was primarily due to an increase in drilling activities, an increase in day rates we charged for our drilling rigs, and an increase in well workover services provided to our customers on production platforms.

Well services turnover increased slightly by RMB0.9 million, or 0.1%, from RMB671.6 million in 2002 to RMB672.5 million in 2003. Turnover remained substantially the same as in 2002 mainly because the increase in such well services as directional drilling activities was offset by the decline in logging and cementing.

Turnover from marine support and transportation services increased by RMB29.3 million, or 4.9% from RMB602.7 million in 2002 to RMB632 million in 2003. The increase in turnover mainly resulted from services by the additional five newly-built vessels and an approximate 5% increase in average rates charged to our customers.

Geophysical services turnover increased by RMB88.3 million, or 22.8%, from RMB387.0 million in 2002 to RMB475.3 million. This increase was mainly due to a general increase in 3D seismic data collection activities as well as the prices we charged, and the additional revenue of RMB9.0 million of in seismic data sales in the Gulf of Mexico market.





Other Revenues

Other revenues increased by RMB7.1 million to RMB11.7 million compared to 2002. The increase mainly resulted from our sales of assets.

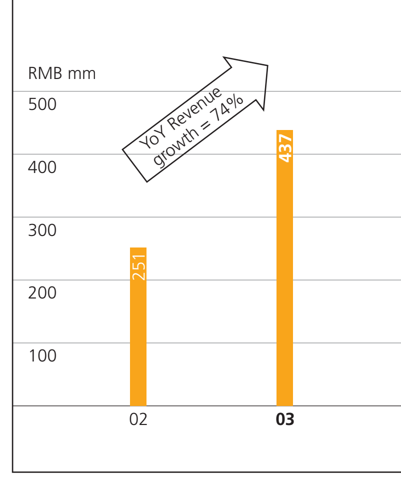
Operating Expenses

Total operating expenses increased by RMB276.8 million, or 12.3%, from RMB2,247.4 million in 2002 to RMB2,524.2 million in 2003. The increase in operating expenses was mainly due to an increase in repair and maintenance costs, lease rental expenses and other operating expenses. Repair and maintenance costs increased by RMB19.4 million, primarily due to an increase in drilling rig maintenance costs. The lease of additional well services equipment and the lease of convoy vessels in connection with growing geophysical activities have lead to an increase of RMB60.0 million in lease rental expenses compared to 2002. Other operating expenses increased by RMB26.1 million, mainly due to an increase in provision for doubtful accounts. Depreciation of property, plant and equipment increased by RMB41.5 million, mainly due to the revaluation of our assets in connection with our restructuring and global offering in April 2002 and the addition of five marine support vessels and other equipment. Other selling, general and administrative expenses, however, decreased by RMB9.0 million.

Drilling services operating expenses increased by RMB208.5 million, or 26.1%, from RMB797.6 million in 2002 to RMB1,006.1 million in 2003. Driven by higher level of drilling activities, employee compensation costs increased by RMB39.0 million, or 24.1%, to RMB201.1 million in 2003. Repair and maintenance costs increased by RMB28.7 million to RMB100.1 million, primarily due to an increase in drilling rig maintenance costs. Operating lease expenses also increased by RMB16.2 million to RMB36.4 million as a result of increased overseas business activities. Other operating expenses increased by RMB18.9 million compared to 2002, mainly due to a larger provision for doubtful accounts. Costs related to the consumption of supplies, raw materials, fuel, services and others increased by RMB62.8 million, or 23.2%, compared to 2002.

IPM Programs

IPM Revenue Contribution

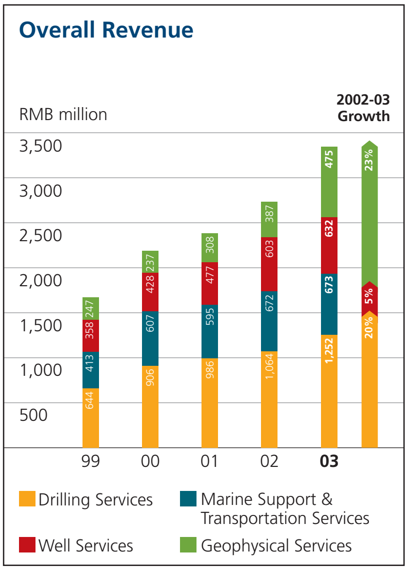


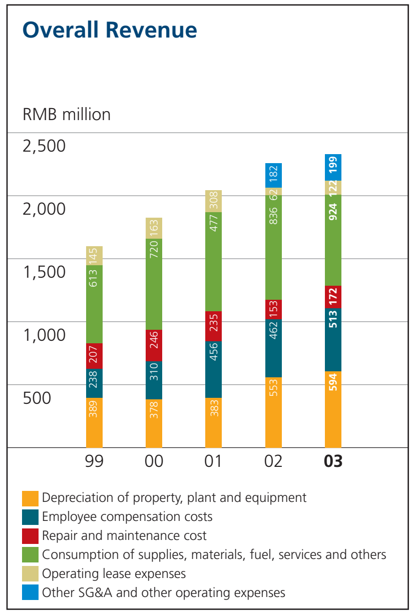
Operating expenses for well services decreased by RMB16.6 million, or 2.8%, from RMB581.7 million in 2002 to RMB 565.1 million in 2003. The decrease in operating costs primarily resulted from a decrease in depreciation charges, repair and maintenance costs and other selling, general and administrative expenses. Depreciation charges decreased by RMB24.6 million to RMB87.5 million, which mainly resulted from the disposal of some of our well services tools and equipment. Other selling, general and administrative expenses fell by RMB9.5 million. Offsetting these decreases, there was an increase in lease of directional drilling equipment resulting in a RMB25.9 million increase in operating lease expenses.

Operating expenses from marine support and transportation services increased by RMB60.3 million, or 12.2%, from RMB493.2 million in 2002 to RMB553.5 million in 2003, primarily due to greater depreciation of fixed assets and operating lease expenses. Depreciation of fixed assets increased by RMB42.6 million to RMB205.4 million as a result of COSL's revaluation of assets and the addition of five new vessels to its marine support fleet. Operating lease expenses increased by RMB4.1 million to RMB9.1 million, mainly because of our rental increase for our offices spaces and other facilities. Offsetting these increases, other selling, general and administrative expenses decreased by RMB2.2 million.

Geophysical services operating expenses increased by RMB24.5 million, or 6.5%, from RMB374.9 million in 2002 to RMB399.4 million in 2003. The increase in operating expenses was mainly due to growing seismic data collection activities, which led to a RMB25.4 million increase in consumption of supplies, raw materials,

Management Discussion & Analysis





fuel, services and others. Operating lease expenses increased by RMB13.8 million, primariy due to increased leasing expenses for convoy vessels associated with the growth of business activities. Offsetting these increases, depreciation expenses decreased by RMB14.3 million, reflecting the devaluation of our seismic vessels following an asset revaluation on April 30, 2002 in connection with our restructuring and global offering.

Operating Profits

Overall operating profits increased by RMB66.8 million, or 13.8%, from RMB483.0 million in 2002 to RMB549.8 million in 2003. Operating profit from geophysical services increased by RMB68.8 million, from RMB12.1 million in 2002 to RMB80.9 million in 2003. Drilling services operating profit recorded a growth of RMB12.3 million, or 4.6%, to reach RMB279.1 million. Well services realized an operating profit of RMB110.5 million, an increase of RMB18.1 million, or 19.6% compared to 2002. Operating profit from our marine support and transportation services decreased by RMB32.5 million, or 29.1% to RMB79.2 million.

Financing Gain / Loss

In 2003, we realized a financing gain of RMB31.5 million, increasing by RMB26.5 million from RMB5.0 million in 2002. This increase was primarily because we did not take out major loans following the repayment of bank and other loans in 2002. As a result, interest expenses decreased by RMB5.3 million while our cash deposit interests increased by RMB20.9 million.

Share of Profit from Jointly-Controlled Entities

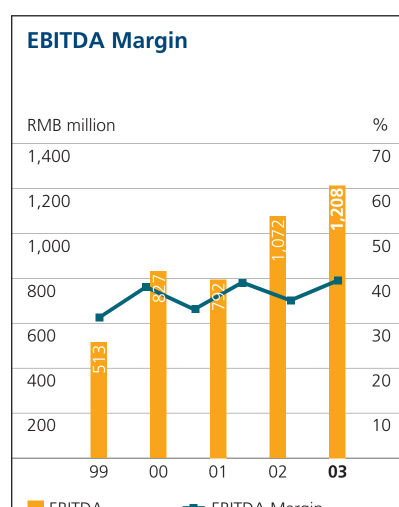
Our share of profit from jointly-controlled entities increased by RMB6.3 million, or 14.8%, from RMB42.6 million in 2002 to RMB48.9 million in 2003. The increase largely resulted from a RMB5.3 million increase of profits from our well services joint ventures and a RMB1.0 million increase of profits from our geophysical services joint ventures.

Profit before Tax

Our profits before tax increased by RMB99.6 million, or 18.8%, from RMB530.6 million in 2002 to RMB630.2 million in 2003, mainly due to a significant improvement in operating results of our drilling services and geophysical services segments.

Taxes

With an increase in profits before tax and a reduction of RMB45.5 million in tax liabilities, our tax expenses decreased by



RMB11.9 million, or 6.8%, from RMB176.2 million in 2002 to RMB164.3 million in 2003.

Profit after Tax

Our profit after tax increased by RMB111.5 million, or 31.5% from RMB354.4 million in 2002 to RMB465.9 million, representing an increase of RMB111.5 million, in 2003.

Distributions

In November 2003, we distributed a special interim dividend of RMB49.0 million. Furthermore, we expect to declare a final dividend distribution of RMB90.7 million for the year 2003.

Debt Servicing Ability

Cash Provided by Operations

Cash provided by operations in 2003 increased by 351.4 million, or 49.3%, from RMB713.3 million in 2002 to RMB1,064.7 million in 2003. While profits from operations increased by RMB66.8 million, depreciation costs increased by RMB41.5 million, and provisions for doubtful debts increased by RMB28.0 million. Increases in our accounts receivable in 2003 were relatively moderate, leading to an RMB103.4 million increase in cash provided by operations. On the other hand, an increase in accounts payable led to a RMB105.0 million increase in cash provided by operations. Moreover, the decrease in inventories also contributed to a RMB17.8 million increase in cash provided by operations.

Capital Expenditures and Investments

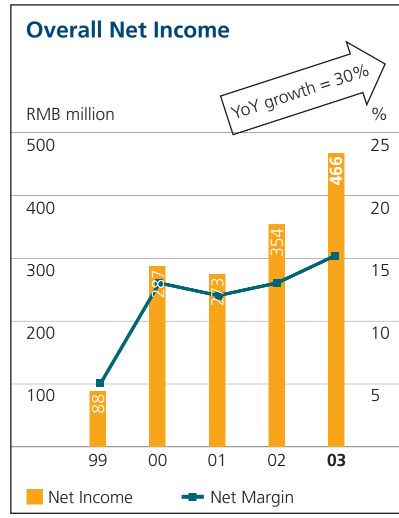
For the year 2003, total capital expenditures increased by RMB492.5 million from RMB763.5 million in 2002 to RMB1,256.0 million (Capital expenditures include cash prepayment/downpayment for plant and equipment which are not yet put into use). Capital expenditures for drilling services, well services, marine support and transportation services and geophysical services were RMB222.0 million, 366.0 million, RMB630.0 million and RMB38.0 million, respectively.

Cash Provided by Financing Activities

We had net cash outflow from financing activities of RMB101.4 million in 2003, consisting largely of cash outflow for dividends.

Outlook

The global economic environment is expected to continue for the better in 2004, and the economies in the USA, Japan and Europe are also expected to experience continued growth. A recent report published by the United Nations forecasted a 3% increase in economic growth for the year 2004. All the above are expected to stimulate oil consumption. Moreover, the robust economic growth in Asian including Chinese markets is expected to further increase global demand for petroleum products. The International Energy Agency predicts that global demand for petroleum products will increase by 1.5% in 2004, and expects global oil consumption to



reach 1.7 million barrels/day in 2004, compared to 1.3 million barrels/day in 2003. Against this backdrop, activities in exploration and development offshore China are expected to grow, and we foresee a considerable increase in capital expenditure for exploration activities offshore China in 2004. As such, we intend to actively prepare ourselves to meet the anticipated increase of market demand for our services in the following ways:

For drilling services, seeing higher demand for exploration and development services offshore China, we will work hard to improve our management to ensure the highest efficiency of services from our drilling rig fleet. At the same time, we will continue to seek opportunities to expand our fleet so as to enhance operating capacity to meet market demand.

Management Discussion & Analysis

For well services, we will put into use the two sets of LWD and MWD tools we acquired in 2003, which will substantially enhance our competitive strengths in the high-end directional drilling market. Our self-developed SAS-IT system will also be put into full operation. In 2004, we will continue our endeavor to improve our technical capabilities, including research and development on peripheral oilfield development and technologies to increase production output and to extract thicker oil. We will also strive to expand our business in manufacturing and sales of certain oilfield technology tools.

For marine support and transportation services, we plan to add nine marine support vessels to our fleet in 2004 with a view to meeting the increasing demand generated by new oil and gas exploration, development and production activities, particularly in the offshore China market.

For geophysical services, we will renovate and upgrade our existing seismic equipment to increase our 3D seismic data collection capacity in 2004. In order to implement COSL's long-term development plan, we will commence the research and development of deep water seismic technology. With respect to survey services, we plan to add an integrated survey vessel to our existing fleet by the end of 2004. The vessel will be designed and built with the ability to inspect and repair marine structures.

In 2004, our main goals will be to maintain steady growth in our oilfield services business. As a result, we will have to maintain a relatively high level of capital expenditures, and to improve the quality and efficiency of our professional oilfield services, we have always eyed on the expansion of our business in domestic onshore and overseas markets, especially the latter. In overseas markets, we will continue to enlarge our market share in Southeast Asia and to selectively pursue other overseas markets with good potentials. In sum, COSL will continue to implement our core development strategies.