

Report of Directors

The directors present their report and the audited financial statements of the Company and its subsidiaries (hereinafter collectively referred as the "Group") for the year ended December 31, 2003.

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 activities of the subsidiaries comprise investment holding and 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 December 31, 2003 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 50 to 92.

A special interim dividend of RMB1.23 cents per ordinary share was paid on December 21, 2003. The directors recommend the payment of a final dividend of RMB2.27 cents per share in respect of the year, to shareholders on the register of members on May 27, 2004. This recommendation has been incorporated in the financial statements as an allocation of retained earnings within the capital and reserves section of 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

The net proceeds from the initial public offering were RMB2,372 million. As at December 31, 2003, the un-utilised proceeds were mostly deposited in interest-bearing accounts in HKD and USD with reputable commercial banks in the PRC as short-term investment as set out in note 23 to the financial statements. The intended use of proceeds as set out in the Company's Prospectus from its global offering and placement in November, 2002, remains unchanged.

Summary financial information

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

Results

| | Years ended December 31, | | | | 2003 RMB'000 |
|---|--------------------------|-----------------|-----------------|-----------------|--------------------|
| | 1999 RMB'000 | 2000 RMB'000 | 2001 RMB'000 | 2002 RMB'000 | |
| | (notes) | (notes) | (notes) | (notes) | (notes) |
| Turnover | 1,662,031 | 2,178,449 | 2,365,566 | 2,725,782 | 3,062,255 |
| Other revenues | 1,556 | 3,196 | 20,996 | 4,600 | 11,720 |
| Operating expenses | | | | | |
| Depreciation of property, plant and equipment | (388,291) | (377,894) | (383,037) | (552,523) | (594,003) |
| Employee compensation costs | (237,705) | (309,791) | (455,480) | (462,293) | (513,098) |
| Repair and maintenance costs | (207,337) | (246,230) | (235,003) | (152,693) | (172,139) |
| Consumption of supplies, materials, fuel, services and others | (611,023) | (719,617) | (793,213) | (836,460) | (924,412) |
| Operating lease expenses | (16,692) | (33,466) | (32,006) | (61,522) | (121,526) |
| Other operating expenses | (82,846) | (76,189) | (78,330) | (139,394) | (138,898) |
| Other selling, general and administrative expenses | (33,632) | (22,765) | (21,903) | (42,475) | (60,124) |
| 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) | (2,524,200) |
| Profit from operations | 74,038 | 364,893 | 349,590 | 483,022 | 549,775 |
| Finance costs | | | | | |
| Exchange losses, net | (468) | 277 | (561) | (973) | (716) |
| Interest expenses | (2,390) | (6,340) | (9,373) | (5,289) | — |
| Interest income | 19,535 | 30,505 | 28,125 | 11,216 | 32,175 |
| | 16,677 | 24,442 | 18,191 | 4,954 | 31,459 |
| Share of profits of jointly-controlled entities | 24,242 | 30,961 | 47,837 | 42,600 | 48,932 |
| Share of loss of an associate | — | (33,781) | (3,434) | — | — |
| Profit before tax | 114,957 | 386,515 | 412,184 | 530,576 | 630,166 |
| Tax | (26,750) | (99,659) | (139,106) | (176,190) | (164,260) |
| Net profit from ordinary activities attributable to shareholders | 88,207 | 286,856 | 273,078 | 354,386 | 465,906 |

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Summary financial information continued

Assets and liabilities

| | As at December 31, | | | | |
|-------------------|--------------------|------------------|------------------|------------------|--------------------|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| | (notes) | (notes) | (notes) | | |
| Total assets | 4,074,938 | 4,518,434 | 5,030,062 | 7,957,532 | 8,231,055 |
| Total liabilities | (1,369,208) | (1,793,992) | (2,095,057) | (1,776,937) | (1,685,919) |
| | 2,705,730 | 2,724,442 | 2,935,005 | 6,180,595 | 6,545,136 |

Notes:

1. The results of the Group for each of the three years ended December 31, 2001, and assets and liabilities as at December 31, 1999, 2000 and 2001 presented above have been extracted from the Company's Prospectus dated November 11 2002 when the listing of the Company's shares was sought on the HKSE.
2. The results of the Group for the year ended December 31, 2002, and assets and liabilities of the Group as at December 31 2002 presented above have been extracted from the pro forma combined profit-and-loss account and consolidated balance sheet as set out on pages 50 and 51 of the financial statements, respectively.
3. The results of the Group for each of the four years ended December 31, 2002, and the assets and liabilities of the Group as at December 31, 2001, 2000 and 1999 have been prepared on a pro forma combined basis as if the current Group structure had been in existence since January 1, 1999.
4. As the business volume of the Group grows, the accounts receivable have also grown. To be conservative with respect to potential risks involved, the other operating expenses included the provisioning of RMB26,928,000 for doubtful accounts. The Group will continue the practice in the future.

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

There was no movement in either the Company's authorised or issued share capital during the year.

Pre-emptive rights

There are no provisions for preemptive 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.

Repurchase, 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.

Distributable reserves

As at December 31, 2003, in accordance with the Company Law of the PRC, an amount of approximately RMB1,976 million standing to the credit of the Company's capital reserve account and an amount of approximately RMB101 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 RMB352 million available for distribution as dividends.

Save as aforesaid, the Company did not have any reserves available for distribution to its shareholders as of December 31, 2003.

Charitable contributions

During the year, the Group made charitable contributions totalling RMB327,500.

Major customers and suppliers

In the year under review, sales to the Group's five largest customers accounted for 74% of the total sales for the year and sales to the largest customer included therein accounted for 57% of the total sales for the year. Purchases from the Group's five largest suppliers accounted for 15% of the total purchases for the year and purchases from the largest supplier included therein accounted for 4.17% of the total sales 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 section headed "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 September 20, 2002) |
| Yuan Guangyu | (Appointed on September 20, 2002) |
| Yang Yexin | (Resigned on November 3, 2003) |
| Li Wenxiang | (Appointed on November 3, 2003) |

Non-executive director:

| | |
|--------------|-----------------------------------|
| Wang Zhongan | (Appointed on September 20, 2002) |
|--------------|-----------------------------------|

Independent non-executive directors:

| | |
|------------------------|-----------------------------------|
| Gordon Che Keung Kwong | (Appointed on October 30, 2002) |
| Richard Paul Margolis | (Resigned on February 28, 2003) |
| Andrew Y. Yan | (Appointed on September 20, 2002) |

Supervisors:

| | |
|---------------|-----------------------------------|
| Liu Shoude | (Appointed on September 20, 2002) |
| Tu Zhimin | (Appointed on September 20, 2002) |
| Zhang Benchun | (Appointed on September 20, 2002) |
| Zhang Dunjie | (Appointed on May 27, 2003) |

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In accordance with the Company's articles of association, all directors and supervisors are elected for 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 36 to 39 of the Annual Report.

Directors' and supervisors' service contracts

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

Apart from the foregoing, no director or supervisor has a service contract with the Company which is not terminable by the Company within one year without payment of compensation, other than statutory compensation.

Details of the directors' and supervisors' remuneration and the five highest paid individuals in the Company are set out in note 10 to the financial statements.

Directors' and supervisors' interests in contracts

None of the directors and supervisors had a material interest, either directly or indirectly, 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.

Directors' and supervisors' interests in competing business

During the year and up to the date of this report, none of the directors or supervisors had or has any interest in a business which competed, competes or may compete with the business of the Group under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

Contracts of significance

The Company has entered into several agreements with CNOOC Limited, a fellow subsidiary of the Company, and with 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 35 to the financial statements.

Directors', chief executive's and supervisors' interests and short positions in shares and underlying shares

As at December 31, 2003, none of the directors, chief executive officer or supervisors had registered an interest or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO"), that was required to be recorded pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

Directors', chief executive's 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 directors, chief executive and supervisors or their respective spouse or minor children, 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.

Material Litigation and Contingent Liabilities

During 2003, the Company had no material litigation or contingent liabilities.

Mortgages and Guarantees

During 2003, the Company gave no mortgages or guarantees.

Substantial shareholders' and other persons' interests in shares and underlying shares

At December 31, 2003, the following interests of 5% or more of the issued share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Long positions:

| Name | Capacity and nature of interest | Number and Class of shares | Approximate percentage in the same class of shares | Approximate percentage of issued share capital |
|--|---|-------------------------------|--|--|
| China National Offshore Oil Corporation ("CNOOC") | Directly beneficially owned | 2,460,468,000 domestic shares | 100.00% | 61.58% |
| J.P. Morgan Chase & Co. | Directly beneficially owned | 242,276,000 H shares | 15.78% | 6.07% |
| | Through a controlled corporation (note a) | 143,027,000 H shares | 9.32% | 3.58% |
| The Capital Group Companies, Inc | Directly beneficially owned | 212,048,800 H shares | 13.82% | 5.31% |
| J.P. Morgan Chase Bank | Directly beneficially owned (note a) | 143,027,000 H shares | 9.32% | 3.58% |
| Morgan Stanley | Directly beneficially owned | 121,389,000 H shares | 7.91% | 3.04% |
| Government of Singapore Investment Corporation Pte. Ltd. | Directly beneficially owned | 77,139,000 H shares | 5.03% | 1.93% |

(a) The ordinary shares are held by J.P. Morgan Chase Bank, which is wholly owned by J.P. Morgan Chase & Co.

Save as disclosed above, to the best of the knowledge of the directors, no person had registered an interest in the shares of the Company that was required to be recorded pursuant to Section 336 of the SFO.

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Connected transactions

Upon the listing of the H Shares of the Company on the HKSE on November 20 2002, transactions between the Group and its connected persons or their respective associates (as the respective terms are defined under the HKSE Listing Rules) are governed by and are required to comply with the requirements of the HKSE Listing Rules. During the year ended December 31 2003, the Group had the following connected transactions:

| | Consolidated for the year ended December 31, 2003 RMB'000 |
|---|--|
| | (Note) |
| A. Gross revenue earned from provision of services to the following related parties: | |
| a. CNOOC Limited Group | |
| Provision of drilling services | 639,199 |
| Provision of well services | 463,312 |
| Provision of marine support and transportation services | 334,924 |
| Provision of geophysical services | 237,471 |
| | 1,674,906 |
| b. CNOOC Limited Group as operator under production sharing contracts | |
| Provision of drilling services | 49,556 |
| Provision of well services | 10,376 |
| Provision of marine support and transportation services | 48,630 |
| Provision of geophysical services | — |
| | 108,562 |
| c. CNOOC Group (including services provided by China Nanhai-Magcoabar Mud Corporation Ltd. ("Magcoabar")) | |
| Provision of drilling services | 29,181 |
| Provision of well services | 33,150 |
| Provision of marine support and transportation services | 69,361 |
| Provision of geophysical services | 35,067 |
| | 166,759 |
| d. Jointly-controlled entities | |
| Provision of drilling services | 1,309 |
| Provision of well services | 30,254 |
| | 31,563 |

Connected transactions *continued*

| | Consolidated for the year ended December 31, 2003 RMB'000 |
|--|--|
| | (Note) |
| B. Included in operating expenses (including services provided to Magcobar) | |
| Services provided by the CNOOC Group: | |
| Labour services | 16,698 |
| Materials, utilities and other ancillary | 59,900 |
| Transportation services | 3,095 |
| Lease of office, warehouse, and berths | 16,666 |
| Lease of equipment | — |
| Repair and maintenance services | 2,361 |
| Management services | 15,789 |
| | 114,509 |
| C. Deposits placed with CNOOC Finance Company at December 31, 2003 | 252,552 |
| D. Interest income earned from deposits placed with CNOOC Finance Company | 2,369 |

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 Hong Kong Stock Exchange ("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.

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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.

The auditors of the Company have reviewed such transactions and have provided a letter to the Company stating that:

1. the transactions had been approved by the Company's directors;
2. the transactions were entered into in accordance with the pricing policies of the Company and its subsidiaries;
3. the transactions were entered into in accordance with the terms of the agreements governing such transactions;
4. such transactions, where applicable, did not exceed 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 HKSE Listing Rules, 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 discussed auditing, internal control and financial reporting matters including the review of audited 2003 annual results with the management.

Auditors

Ernst & Young will 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

Yuan Guangyu

Director

Hong Kong
March 23, 2004