

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 31 December 2004.

### **PRINCIPAL ACTIVITIES AND OPERATING RESULTS**

The principal activity of the Company is investment holding of its subsidiaries, (together with the Company are referred to as the "Group"). These subsidiaries are principally engaged in the exploration, development, production and sales of crude oil and natural gas and other petroleum products.

### **SUMMARY OF FINANCIAL INFORMATION**

Please refer to the financial statements for a summary of the assets and liabilities of the Group as at 31 December 2004 on page 61 and the operating results for the year then ended on page 60.

### **LOANS**

Please refer to note 26 to the financial statements on pages 92 to 93, for details of the long-term bank loans of the Group for the year ended 31 December 2004.

### **PROPERTY, PLANT AND EQUIPMENT**

Please refer to note 18 to the financial statements on pages 85 to 87 for net

movements in property, plant and equipment of the Group for the year ended 31 December 2004.

### **RESERVES**

Please refer to the statement of changes in equity on page 62 and note 32 to the financial statements on page 99 to 100 for movements in the reserves of the Group and the Company, respectively, for the year ended 31 December 2004.

### **SUBSIDIARIES AND ASSOCIATED COMPANIES**

Particulars of the Company's subsidiaries and associated companies as at 31 December 2004 are set out in notes 19 and 20 to the financial statements on pages 87 to 90.

### **DIVIDENDS**

The Directors recommend the payment of a final dividend of HK\$0.03 per share and a special final dividend of HK\$0.05 per share for the year ended 31 December 2004.

### **RETIREMENT BENEFITS**

Please refer to note 33 to the financial statements on page 100 for details of the retirement benefits of the Group for the year ended 31 December 2004.

### **MAJOR SUPPLIERS AND CUSTOMERS**

Purchases from the largest supplier of the Group for the year ended 31 December 2004

represented approximately 15.3% of the Group's total purchases. The total purchases attributable to the five largest suppliers of the Group accounted for approximately 33.2% of the total purchases of the Group for the year then ended.

Sales to the largest customer for the year ended 31 December 2004 represented approximately 19.3% of the Group's total revenue. The total sales attributable to the five largest customers of the Group accounted for approximately 53.1% of the total oil and gas sales of the Group for the year then ended.

Save as disclosed in this report, none of the directors or their respective associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5% the Company's share capital) had any interests in the five largest suppliers or customers of the Group.

### **CONNECTED TRANSACTIONS**

The Independent Non-executive Directors have confirmed that the following connected transactions for the year ended 31 December 2004 to which any member of 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 to the Group than those available to or from independent third parties; and
3. on terms that were fair and reasonable so far as the shareholders of the Company were concerned and in the interests of the shareholders of the Company as a whole.

The Independent Non-executive Directors have further confirmed that for the year ended 31 December 2004:

1. the aggregate annual volume of transactions under the materials, utilities and ancillary services supply agreements did not exceed 10% of the audited consolidated total revenues of the Group in the year ended 31 December 2003;
2. the aggregate annual volume of transactions in relation to technical services did not exceed RMB7,338 million;
3. the aggregate annual volume of transactions in relation to research and development services for particular projects did not exceed RMB148 million;

4. the aggregate annual volume of transactions in relation to sales of crude oil, condensate oil and liquefied petroleum gas did not exceed 56% of the audited consolidated total revenues of the Group in the year ended 31 December 2003;
5. the amount paid under the general research and development services agreement did not exceed RMB110 million;
6. the aggregate amounts paid under the lease and management agreements did not exceed RMB78 million; and
7. the maximum outstanding balance of deposits (including interest received in respect of these deposits) placed with CNOOC Finance Corporation Limited did not exceed RMB6,800 million.

The auditors of the Group have reviewed the transactions referred to in the above paragraph 1 to paragraph 7 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;
3. the transactions were entered into in accordance with the terms of the agreements governing the transactions; and

4. the amount of the transactions have not exceeded the cap for which waiver was granted.

Please refer to note 29 to the financial statements on pages 94 to 96 for a summary of the related party transactions which include the Group's connected transactions.

#### SHARE CAPITAL

Please refer to note 31 to the financial statements on pages 97 to 99 for details of movements in the Company's share capital for the year ended 31 December 2004.

#### ISSUE OF BONDS

In November 2004, CNOOC Finance (2004) Limited, a wholly-owned subsidiary of the Company issued zero coupon convertible bonds with a total amount of US\$1,000,000,000 due 2009 (the "Convertible Bonds"). The Company intends to use the net proceeds of the bonds for general corporate purposes. In accordance with the terms and conditions of the Convertible Bonds, the payment of the proposed final dividend may result in an adjustment to the conversion price of the Convertible Bonds. The exact amount of the adjustment, if any, can only be determined after the record date for the proposed final dividend. A separate announcement will be made as and when appropriate.

### SHARE OPTION SCHEMES

The Company has adopted share option schemes which provide for the grant of options to the Company's senior management. Under these share option schemes, the remuneration committee of the Company's board of directors will from time to time propose for the board's approval for the recipient of and the number of shares underlying each option. Each scheme provides for issuance of options exercisable for shares granted under each scheme as described below not exceeding 10% of the issued share capital of the Company as at the date when limit of such scheme is refreshed from time to time, excluding shares issued upon exercise of options granted under each schemes.

On 4 February 2001, the Company adopted a pre-global offering share option scheme (the "Pre-Global Offering Share Option Scheme"). Pursuant to the Pre-Global Offering Share Option Scheme:

1. options for an aggregate of 23,100,000 shares have been granted;
2. the subscription price per share is HK\$1.19; and
3. the period during which an option may be exercised is as follows:
  - (a) 50% of the shares underlying the option shall vest 18 months after the date of the grant; and

- (b) 50% of the shares underlying the option shall vest 30 months after the date of the grant.

The exercise period for options granted under the Pre-Global Offering Share Option Scheme will end not later than 10 years from 12 March 2001.

On 4 February 2001, the Company adopted a share option scheme (the "2001 Share Option Scheme") for the purposes of recognising the contribution that certain individuals had made to the Company and attracting and retaining the best available personnel to the Company.

Pursuant to the 2001 Share Option Scheme:

1. options for an aggregate of 44,100,000 shares have been granted;
2. the subscription price per share is HK\$1.232; and
3. the period during which an option may be exercised is as follows:
  - (a) one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
  - (b) one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and

- (c) one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2001 Share Option Scheme ends not later than 10 years from 27 August 2001.

In view of the amendments to the relevant provisions of the Listing Rules regarding the requirements of share option schemes of a Hong Kong listed company effective on 1 September 2001, no further options will be granted under the 2001 Share Option Scheme.

In June 2002, the Company adopted a new share option scheme (the "2002 Share Option Scheme").

Under the 2002 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 in the Company. The maximum aggregate number of shares (including those that could be subscribed for under the Pre-Global Offering Share Option Scheme and the 2001 Share Option Scheme) which may be granted shall not exceed 10% of the total issued share capital of the Company. The maximum number of shares which may be granted under the 2002 Share Option Scheme to any individual

in any 12-month period up to the next grant of share options shall not exceed 1% of the total issued share capital of the Company from time to time.

According to the 2002 Share Option Scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. 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 Stock Exchange of Hong Kong ("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.

On 24 February 2003, the board of directors approved to grant options in respect of 42,050,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK\$2.108 per share. The market price was HK\$2.11 per share preceding the options

granted. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

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.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from the date on which the option is granted.

On 5 February 2004, the board of directors approved a grant of options in respect of 50,700,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK\$3.152 per share. The market price was HK\$3.146 per share preceding the options granted. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

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.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from the date on which the option is granted.

2,300,100 share options granted under the 2002 Share Option Scheme and the 2001 Share Option Scheme have been exercised since the respective dates of grant and up to the date when the board of directors approved the financial statements. The total number of options exercisable as of 31 December 2004 was 54,533,267.

The weighted average fair value of the options granted under the Pre-Global Offering Share Option Scheme, the 2001 Share Option Scheme and the 2002 Share Option Scheme at the grant dates was HK\$0.84 per share. 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%, 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

During the year ended 31 December 2004, the Company purchased shares of the Company listed on the HKSE as follows:

Date of purchase	Aggregate number of shares purchase	Aggregate price paid by the Company for the purchase (HK\$)
18 May 2004	5,427,000	15,529,360.50
24 May 2004	3,450,000	10,682,580.00
17 June 2004	7,140,000	23,328,522.00
21 June 2004	876,000	2,744,420.40
2 July 2004	500,000	1,637,500.00
8 July 2004	1,060,000	3,485,492.00

All the shares purchased by the Company have been cancelled. Save as described above, there was no other repurchase, sale on, redemption by the Company, or any of the Company's subsidiaries during the twelve months ended 31 December 2004.

### SUBSTANTIAL INTERESTS IN SHARE CAPITAL

The register maintained by the Company pursuant to the Securities and Futures Ordinance ("SFO") recorded that, as at 31 December 2004, the following corporations had the interests (as defined in the SFO) in the Company set opposite their respective names:

		Number of ordinary shares held	Percentage of Total Issued Shares
(i)	CNOOC (BVI) Limited "CNOOC (BVI)"	28,999,999,995	70.64%
(ii)	Overseas Oil & Gas Corporation, Limited ("OOGC")	28,999,999,995	70.64%
(iii)	China National Offshore Oil Corporation ("CNOOC")	28,999,999,995	70.64%

CNOOC (BVI) is a wholly-owned subsidiary of OOGC, which is a wholly-owned subsidiary of CNOOC.

Accordingly, CNOOC (BVI)'s interests are recorded as the interests of OOGC and CNOOC.

All the interests stated above represent long positions. As at 31 December 2004, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

### DIRECTORS AND SENIOR MANAGEMENT OF THE COMPANY

Please refer to pages 41 to 43 for information concerning the Directors and senior management of the Company.

### DIRECTORS' INTERESTS

As at 31 December 2004, the interests of the Directors and the chief executive of the Company in the equity securities of the Company and its associated corporations (all within the meaning of Part XV of the SFO) as recorded in the register required to be kept under section 352 of the SFO or disclosed in accordance with the Listing Rules comprised only the personal interest in options to subscribe for shares in the Company are detailed below.

As at 31 December 2004, the following Directors and employees of the Group had the personal interests in options to subscribe for shares in the Company granted under the share option schemes of the Company:

Name of Grantee	No. of shares involved in the options outstanding at the beginning of the period	No. of shares involved in the options outstanding at the end of the period*	Date of Grant	Closing price per share immediately before the date on which the options were granted (HK\$)*		Exercise Price (HK\$)*
				Before adjusted as per Share Subdivision	Adjusted as per Share Subdivision	
Directors:						
Fu Chengyu	350,000	1,750,000	12 Mar 2001	—	—	1.19
	350,000	1,750,000	27 Aug 2001	7.30	1.46	1.232
	230,000	1,150,000	24 Feb 2003	10.45	2.09	2.108
	500,000	2,500,000	5 Feb 2004	15.65	3.13	3.152
Luo Han	280,000	1,400,000	12 Mar 2001	—	—	1.19
	230,000	1,150,000	27 Aug 2001	7.30	1.46	1.232
	230,000	1,150,000	24 Feb 2003	10.45	2.09	2.108
	230,000	1,150,000	5 Feb 2004	15.65	3.13	3.152
Jiang Longsheng	280,000	1,400,000	12 Mar 2001	—	—	1.19
	230,000	1,150,000	27 Aug 2001	7.30	1.46	1.232
	230,000	1,150,000	24 Feb 2003	10.45	2.09	2.108
	230,000	1,150,000	5 Feb 2004	15.65	3.13	3.152
Zhou Shouwei	280,000	1,400,000	12 Mar 2001	—	—	1.19
	350,000	1,750,000	27 Aug 2001	7.30	1.46	1.232
	350,000	1,750,000	24 Feb 2003	10.45	2.09	2.108
	350,000	1,750,000	5 Feb 2004	15.65	3.13	3.152

Name of Grantee	No. of shares involved in the options outstanding at the beginning of the period	No. of shares involved in the options outstanding at the end of the period*	Date of Grant	Closing price per share immediately before the date on which the options were granted (HK\$)*		Exercise Price (HK\$)*
				Before adjusted as per Share Subdivision	Adjusted as per Share Subdivision	
Chiu Sunghong	230,000	1,150,000	5 Feb 2004	15.65	3.13	3.152
Kenneth S Curtis	230,000	1,150,000	5 Feb 2004	15.65	3.13	3.152
Erwin Schurtenberger	230,000	1,150,000	5 Feb 2004	15.65	3.13	3.152
Evert Henkes	230,000	1,150,000	5 Feb 2004	15.65	3.13	3.152
Others	3,430,000	17,150,000	12 Mar 2001	—	—	1.19
	7,660,000	38,300,000	27 Aug 2001	7.30	1.46	1.232
	7,370,000	36,850,000	24 Feb 2003	10.45	2.09	2.108
	7,910,000	39,550,000	5 Feb 2004	15.65	3.13	3.152

\* Adjustment has been made to take account of the subdivision of issued and unissued shares of HK\$0.10 each into five shares of HK\$0.02 each effective on 17th March 2004 ("Share Subdivision")

As at 31 December 2004, no options granted under the share option schemes of the Company had been exercised.

All the interests stated above represent long positions. As at 31 December 2004, no short positions were recorded in the Register of Directors' and Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Other than those disclosed above, no right to subscribe for equity or debt securities of the Company has been granted by the Company to, nor have any such rights been exercised by, any person during the half year ended 31 December 2004.

#### DIRECTORS' INTERESTS IN CONTRACTS

No re-electing director has an unexpired service contract with the Company which is not determinable by the Company within one year without payment of compensation (other than normal statutory obligations).

Save as disclosed in this report, no contract of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the reporting year or at anytime during the reporting year.

#### **EMOLUMENTS OF THE DIRECTORS AND THE FIVE HIGHEST PAID INDIVIDUALS**

Please refer to notes 12 and 13 to the financial statements on pages 80 to 83 for details of the emoluments of the Directors and the five highest paid individuals of the Company.

#### **MATERIAL LEGAL PROCEEDINGS**

As at 31 December 2004, 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 so far as the Company is aware.

#### **COMPLIANCE WITH THE CODE OF BEST PRACTICE**

Throughout the year ended 31 December 2004, the Company has complied with the Code of Best Practice contained in Appendix 14 to the Listing Rules then in force during the year ended 31 December 2004, 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.

Appendix 14 to the Listing Rules was substantially revised during 2004. The Code of Best Practice contained in Appendix 14 to the Listing Rules has been replaced by the Code of Corporate Governance Practice with effect from 1 January 2005 and the new Code will apply for subsequent reporting periods.

#### **AUDITORS**

Ernst & Young were appointed as the auditors of the Company for the year ended 31 December 2004 and has audited the accompanying financial statements. A resolution to re-appoint Ernst & Young as auditors of the Company will be proposed at the forthcoming annual general meeting.

#### **SUFFICIENCY OF PUBLIC FLOAT**

As at the date of this report, the Directors acknowledge that based on publicly available information and within the knowledge of the Directors, the Company had sufficient public float as required under the Listing Rules.

#### **PROCEDURES FOR DEMANDING A POLL**

Pursuant to Article 69(a) of the articles of association of the Company, a resolution put to the vote of a general meeting shall be decided on a show of hands unless (before or on the declaration of the result of the show

of hands or on the withdrawal of any other demand for a poll) a poll is demanded by:

- (i) the Chairman of such meeting; or
- (ii) at least three members present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and entitled to vote at the meeting; or
- (iii) any member or members present in person or by proxy (or in the case of a member being a corporation, by its duly authorised representative) and representing in the aggregate not less than one-tenth of the total voting rights of all members having the right to attend and vote at the meeting; or
- (iv) any member or members present in person or by proxy and holding shares conferring a right to attend and vote at the meeting (or in the case of a member being a corporation, by its duly authorised representative) on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

By Order of the Board

**Fu Chengyu**  
*Chairman*

Hong Kong, 29 March 2005