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OUTLOOK

In 2004, international oil prices stayed high, whilst the Company's production and reserves increased steadily, with attractive revenue and promising results achieved. We expect that the Company will perform even better in 2005.

Despite the various unfavorable factors, the development of global economy remained vigorous in 2004. In 2005, there are still some worries over the development of the global economy. Although the growth of the global economy may slow down, its outlook is promising.

The Company's principal businesses are concentrated in the Asia Pacific region. In 2005, the speed of economic development in this region may slow down, but will remain sound. China, where most of the Company's assets are concentrated, will still be one of the major drive forces in the development of the global economy. In 2005, China will be integrated with the global mainstream political and economic development in a more active manner in terms of both attitude and action. There will still be more room for the development of the economy of China. We believe that under the guidance of the State macro control policies, the economic growth in China will be more balanced.

In respect of the development trends of the oil price in 2005, analysts are holding different opinions, while the management is prudently optimistic to the trends. In 2005, since demands for international crude oil will continue to grow, there may exist new changes in the political and economic situation in the Mid East regions, in addition to the impact of speculations and unexpected incidents, international oil prices may remain high.

The management will continue to cope with various external unfavorable factors so as to mitigate any negative impact to the Company's development.

2005 is a key year for our production. Nine new projects will commence operation during the year. It will also be a year with the largest number of projects planning to commence operation in a single year in the Company's history.

In 2005, we will focus on the new sectors and the prospects of reserves in deep water areas. Emphasis will continue to be placed in the enhancement of production volume and reserves so as to maintain the competitiveness of the cost structure of the Company. Innovation in management will be promoted. Internal control system and mechanism will be established and upgraded to comply with regulatory requirements in the market. We will endeavour to attain efficiency and maximize return for our shareholders.

The management is confident in the prospects of continuous growth of the Company.

CONSOLIDATED NET PROFIT

Our consolidated net income after tax was RMB16,185.8 million (US$1,955.6 million) in 2004, an increase of RMB4,650.3 million (US$561.8 million), or 40.3% from RMB 11,535.5 million in 2003.

REVENUE

Income from our oil and gas sales for 2004 was RMB36,886.0 million (US$4,456.6 million), an increase of RMB8,769.2 million (US$1,059.5 million), or 31.2% from RMB 28,116.8 million in 2003. The increase was attributable to the high oil price, whilst growth in production also attributed to higher profits in the Company. The average realized price for our crude oil was US$35.41 per barrel in 2004, an increase of US$7.3, or 26.0% from US$28.11 per barrel in 2003. Sale of crude oil amounted to 116.3 million barrels, an increase of 5% over 2003. The average realised price for our natural gas was US$2.75 per thousand cubic feet in 2004, a decrease of 4%, due to the increased weighting of production of low-price gas fields. At the same time, sales volume of our natural gas increased by 26% from 2003, which effectively compensated the drop in the gas price. Sales income of our natural gas increased by RMB480.0 million.

In 2004, our net marketing profit, which were derived from marketing revenue less purchase cost of crude oil and oil products, were RMB227.9 million (US$27.5 million), an increase of RMB124.5 million (US$15.0 million), or 120.3%, from RMB103.4 million. Since we are one of the three companies that have the right to sell crude oil in China, we can purchase the oil from our foreign partners for sale in China at the request of our partners. However, our ability to sell oil in China depends on our foreign partners, and, therefore, we cannot control the amount of crude oil that we are able to sell for a specific period. Marketing revenue from the Company's wholly-owned subsidiary, China Offshore Oil (Singapore) International Pte Ltd., was RMB10,448.8 million (US$1,262.4 million), less purchase cost of crude oil and oil production, the net marketing profit was RMB71.3 million (US$8.6 million), or 36.1% increased from same period last year.

Our other income, reported on a net basis, was derived from our other income less corresponding costs. In 2004, our other net income was RMB98.8 million (US$11.9 million), an increase of RMB14.3 million (US$1.7 million) from RMB84.5 million in 2003.

EXPENSES

Operating expenses

Our operating expenses in 2004 were RMB5,070.3 million (US$612.6 million), an increase of RMB557.5 million (US$67.4 million), or 12.4% from RMB 4,512.8 million in 2003. The increase was mainly attributable to the commencement of production of 6 new oil and gas fields in China in the year, resulting in higher cost during the initial stage of production. Operating expenses in 2004 were RMB36.7 (US$4.43) per BOE, an increase of 4.2% from RMB 35.2 (US$4.25) per BOE in 2003. Operating expenses offshore China in 2004 were RMB29.9 (US$3.61) per BOE, an increase of 10.7% from 2003. The increase was mainly attributable to the higher service fees, especially in supply vessels, equipment lease, maintenance materials and fuel, resulting from higher international crude oil price. Operating expenses offshore Indonesia in 2004 were RMB88.7 (US$10.72) per BOE, an increase of 15.6% from 2003. The increase was attributable to the international crude oil price which maintain a high level, and the increase in operating expenses per barrel for our Indonesian oil fields due to lower production volume based on their profit sharing mode. Based on working interest production, operating expenses in offshore Indonesia in 2004 was RMB42.0 (US$5.08) per BOE, which was in line with the previous year.

Production taxes

Our production taxes for 2004 were RMB1,725.7 million (US$208.5 million), an increase of RMB487.1 million (US$58.9 million), or 39.3% from RMB 1,238.6 million in 2003. The increase was mainly due to the increase in oil and gas sales.

Exploration costs

Our exploration costs for 2004 were RMB1,316.2 million (US$159.0 million), an increase of RMB468.1 million (US$56.6 million), or 55.2% from RMB 848.1 million in 2003. The increase was mainly due to the significant increase in the exploration works in the year. In 2004, some successful exploration wells have been written-off since they won't be developed in the next one or two years after reviewing by company. The write-off amount was RMB155.8 million (US$18.8 million) during the year.

Depreciation, depletion and amortization

Our depreciation, depletion and amortization were RMB5,455.1 million (US$659.1 million) for 2004, an increase of RMB812.3 million (US$98.1 million), or 17.5% from RMB 4,642.8 million in 2003. Our average depreciation, depletion and amortization per barrel were RMB39.5 (US$4.77) per BOE, an increase of 9.2% from RMB 36.2 (US$4.37) per BOE in 2003. The increase was mainly due to higher amortization expenses of the new commencement oil fields, resulting in rising material prices. On the other hand, the reduction in the net production of the Indonesian oil fields was subject to the influence of oil prices, resulting in further increase in amortization expenses per barrel as well as average amortization expenses.

Dismantlement

Our dismantling costs for 2004 were RMB201.6 million (US$24.4 million), an increase of RMB34.3 million (US$4.1 million) from RMB 167.3 million in 2003. The increase was primarily due to the increased dismantling costs resulting from the commencement of production at new oil and gas fields. Our average dismantling costs were RMB1.5 (US$0.18) per BOE, a slight increase from RMB1.3 (US$0.16) per BOE in 2003.

Selling and administrative expenses

Our selling and administrative expenses for 2004 were RMB1,057.7 million (US$127.8 million), a decrease of RMB154.8 million (US$18.7 million), or 12.8% from RMB 1,212.5 million in 2003. Of which, the selling and administrative expenses of companies in China were RMB5.5 (US$0.66) per BOE, a decrease of 17.5% from the previous year. This was mainly attributable to some of the labor costs being directly charged into related projects, and the replacement of foreign employees by local staff.

Net interest income/expenses

Our net interest expenses for 2004 was RMB235.0 million (US$28.4 million), an increase of 37.1% from the net interest expenses of RMB 171.4 million in 2003, which was mainly due to the interest expenses on our US$ 500 million bonds issued in 2003. An increase of RMB94.8 million (US$11.5 million) in interest expenses was caused by our long term guaranteed notes.

Exchange gains/losses, net

Our net exchange gain incurred in 2004 was RMB29.3 million (US$3.5 million), an increase of RMB36.0 million (US$4.3 million) from a net exchange loss of RMB 6.7 million in 2003. Compared with 2003, the position of exchange turnaround from loss to gain, where the exchange loss was set off by our foreign exchange swap business.

Short term investment income

Our short term investment income for 2004 was RMB72.4 million (US$8.7 million), a decrease of RMB51.1 million (US$6.2 million), or 41.4% from RMB 123.5 million in 2003. Subject to the influence from the market, we disposed some investment in corporate bonds and reinvest in market funds. Thus, the average return on short term investments for the year fell due to the structural change.

Share of profit of associates

In 2004, there were gain from our investments in Shanghai Petroleum and Natural Gas Company Limited and CNOOC Finance Corporation Limited. Of which, share of profit from Shanghai Petroleum and Natural Gas Company Limited was RMB297.8 million (US$36.0 million), an increase of 35.2% from 2003, which was mainly due to the increase in oil prices in 2004. Share of profit from CNOOC Finance Corporation Limited was RMB46.7 million (US$5.6 million) during the period.

Non-operating income/expenses, net

Our net non-operating income for 2004 was RMB519.2 million (US$62.7 million), and our net non-operating income for 2003 was RMB 315 million. The non-operating income in both two years were due to the tax refund from re-investment in China.

Income tax

Our income tax for the year 2004 was RMB6,930.8 million (US$837.4 million), an increase of RMB2,303.0 million (US$278.2 million), or 49.8% from RMB 4,627.8 million in 2003. The primary reason for the increase was the increase in profit before tax. In 2003, we received RMB 252.0 million tax rebate from using domestic equipments. The effective tax rate for 2004 was 30.3%, slightly higher than the effective rate of 28.6% in 2003.

Cash generated from operating activities

Net cash generated from operating activities in 2004 amounted to RMB22,327.9 million (US$2,697.6 million), an increase of RMB4,509.1 million (US$544.8 million), or 25.3% from RMB 17,818.7 million in 2003.

The increase in cash was mainly due to an increase in profit before tax of RMB6,953.3 million (US$840.1 million), an increase in depreciation, depletion and amortization expenses of RMB812.3 million (US$98.1 million), an increase in dismantling costs of RMB34.3 million (US$4.1 million), and an increase in write-off exploration wells and disposal of fixed assets of RMB116.1 million (US$14.0 million) in the year.

Increase of cash flow was partially offset by an increase of income tax of RMB3,887.5 million (US$469.7 million), an increase in our share of profits of associates of RMB124.2 million (US$15.0 million), an increase in net interest expenses of RMB63.6 million (US$7.7 million), an increase of net exchange gain of RMB36.0 million (US$4.4 million), the provision for inventory obsolescence of RMB11.5 million (US$1.4 million), and a decrease in short term investment income and others of RMB55.0 million (US$6.7 million).

In addition, operating cash flow was increased due to the decrease of working capital, mainly due to the decrease in current liabilities from operating activities of RMB332.1 million (US$40.1 million), and a simultaneous decrease in current assets from operating activities excluding cash and bank balances of RMB1,031.7 million (US$124.6 million).

Capital expenditures and investments

Net cash outflow from investing activities in 2004 was RMB24,607.2 million (US$2,973.0 million), an increase of RMB15,094.6 million (US$1,823.7 million) from RMB9,512.6 million in 2003.

In line with our use of successful efforts method of accounting, total capital expenditures and investments primarily include successful exploration and development expenditures and purchases of oil and gas properties. Total capital expenditures were RMB18,622.0 million (US$2,250.0 million) in 2004, an increase of RMB6,249.5 million (US$755.1 million), or 50.5%, from RMB12,372.5 million in 2003. Capital expenditures in 2004 mainly comprised RMB783.5 million (US$94.7 million) for capitalized exploration activities, RMB12,059.4 million (US$1,457.0 million) for development investments, and RMB5,779.1 million (US$698.2 million) for acquisition of oil and gas properties of Tangguh, NWS and other projects. Our development expenditures in 2004 related principally to the development of Bozhong 25-1/25-1S, Luda, Bonan and Caofeidian oil and gas fields.

In addition, cash out flow was attributable to increase in time deposits with maturities over three months of RMB 6,280 million (US$758.7 million), and RMB 294.8 million (US$ 35.6 million) cash inflow was generated from net disposal of short-term investment.

Financing activities

The net cash flow arising from financing activities in 2004 was inflow of RMB1,970.5 million (US$238.1 million). The issue of US$1 billion convertible bonds in December 2004 generated cash inflow of RMB8,154.1 million (US$985.2 million). Such cash inflow was partially set off by repayment of bank loans of RMB21.1 million (US$2.5 million), appropriation of dividend of RMB6,101.4 million (US$737.2 million), and a cash outflow of RMB61.2 million (US$7.4 million) resulted from the repurchase of shares by the Company in 2004.

Repayment arrangements of our total debts as at 31 December 2004 were as follows:

Debt maturities principal only

Original currency

Due by 31 December	**US$**	**JPY**	**RMB**	**Total RMB equivalent**	**Total US$ equivalent**
			(in millions, except percentages)		
2005	—	271.5	—	24.3	2.9
2006-2008	100.0	542.9	—	865.2	104.5
2009-2010	983.1	—	—	8,156.4	985.5
2011 and beyond	981.1	—	—	8,157.2	985.6
Total	2,064.2	814.4	—	17,203.1	2,078.5
Percentage of total debt	99.3%	0.7%	—	100.0%	100.0%

The gearing ratio of the Company was 23.3%. Gearing ratio is (Total Debt)/(Total Debt + Equity).

Market risks

Our market risk exposures primarily consist of fluctuations in oil and gas prices, exchange rates and interest rates.

Oil and gas price risk

As our oil and gas prices are mainly determined by reference to the oil and gas prices in international markets, changes in international oil and gas prices have a large impact on us. International oil and gas prices are volatile, and this volatility has a significant effect on our net sales and net profits.

Currency risk

Substantially all of our oil and gas sales are denominated in Renminbi and US dollars. In the past decade, the PRC government's policy of maintaining a stable exchange rate and China's ample foreign reserves have contributed to the stability of the Renminbi. Recently, there has been wide speculation in the international market that the Chinese government will deregulate the Renminbi exchange rate. However, the Chinese government has not determined if or when the exchange rate will be deregulated. Currently, the Renminbi exchange rate remains stable.

In the event of the deregulation in Renminbi exchange rate in the future, we may be adversely affected. At present, we are seriously conducting investigation on this issue, and will actively seek a strategy for its resolution.

As of the end of 2004, the balance of our yen-denominated loans was only 0.81 billion yen. Since we have hedged our yen loans against foreign currency swaps, we do not expect any exchange risk relating to Japanese yen in the future.

Interest rate risk

As of the end of 2004, the interest rates for all the balance of our debts were fixed. The term of the weighted average balance was approximately 9 years, with very low weighted average interest rates. The weighted average interest rates of our debts, including the newly issued convertible bonds in 2004, was only 3.6%. Therefore, if interest rates of US dollars increase in future, our debt combination can effectively avoid the risk of such increase.

Significant investments and material acquisitions

(i) During the year, we acquired 20.767% interests from BG Group at Muturi contract district, at a consideration of US$105.1 million (equivalent to RMB869,881,000). The final price is subject to adjustment. The acquisition increased our interest in the Muturi contract district to 64.767%, and our interest in Tangguh natural gas project in Indonesia from 12.5% to 16.96%. We have completed the acquisition on 12 May 2004.

(ii) On 18 December 2004, we completed the acquisition of the North West Shelf Gas Project in Australia. Disclosure of such acquisition has been made on 15 May 2003. Pursuant to the contract, we acquired 25% interest of the China LNG Joint Venture, a newly established joint venture within the North West Shelf Gas Project in Australia. The Company also obtained certain production licenses, lease certificates in respect of the North West Shelf Gas Project and approximately 5.3% interest in the exploration licenses of North West Shelf Gas Project. At the same time, the Company will enjoy the right to participate in the exploration other than the proved reserves in future.

The NWS Gas Project partners have signed a 25-year LNG agreement to provide LNG to the first LNG terminal in Guangdong, China, beginning in 2006.

(iii) During the year, the Company, through its wholly-owned subsidiary CNOOC Morocco Limited, entered into a farmout agreement with Vanco Energy Corporation, and acquired 11.25% interests in an petroleum agreement for Ras Tafelney at offshore Morocco.

(iv) In addition, the Company also entered into three production sharing contracts with Golden Aaron Pte. Ltd. and China Global Construction Limited in Myanmar during the year, with the company being the operator.

EMPLOYEES

We had 2,524 employees as at 31 December 2004.

We have adopted 3 Share Option Schemes for our senior management officers of the Company since 4 February 2001.

In 2004, in line with our development, we have set up and implemented a corresponding human resources strategy, to provide strong support of human resources so as to cope with the internationalisation development and demands of international competition.

We further implemented a highly effective performance evaluating system, emphasizing on the integration of the individual's development targets and the Company's operating objectives. We are now setting up a performance evaluating systems for our branches, at the same time. Actively promoting the implementation of a performance evaluating system for individuals.

Based on the reform in the previous year, we further implemented the reforms in accordance with new situation and requirements of our developments, and upgraded the salary system and incentive mechanism.

In 2004, the Company continuously to promote the effective training programme.

Through the promotion of the individual development schemes and systems, we managed to organize and implement various specialised and comprehensive management training courses. During the year, a total of 641 training courses were conducted within the Company, which was attended by more than 8,816 participants, and per capita training hours was 42,506.

CHARGES ON ASSETS

The Group had no charge on assets as at 31 December 2004.

CONTINGENT LIABILITIES

The Group had no contingent liabilities as at 31 December 2004.