

REPORT OF THE DIRECTORS

The directors present the report and the audited financial statements of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2004.

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 comprises 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 31 December 2004 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 51 to 83 .

On 25 November 2004, a special interim dividend of RMB2.29 cents per ordinary share, amounting to a total of RMB92 million was paid to the shareholders whose names appear on the register of members on 5 November 2004. Subject to the passing of the necessary resolution at the forthcoming annual general meeting, The directors have recommended the payment of a final dividend of RMB4.39 cents per share in respect of the year, to shareholders whose names appear on the register of members on May 25, 2005. 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. This dividend together with the special interim dividend payment amounts to a total of about RMB267 million. Further details of this accounting treatment are set out in note 13 to the financial statements.

Subsidiaries

Particulars of the company's subsidiaries, as at 31 December 2004 are set out in note 15 to the financial statements.

Use of proceeds from the Company's initial public offering and placement of new shares

The proceeds from the initial public offering, after netting off related expenses paid and payable, were RMB2,372 million. The un-utilised proceeds were mostly deposited in interest-bearing accounts in HKD and USD with commercial banks in the PRC and used as short term investment as set out in note 22 to the financial statements as at 31 December 2004. The intended use of proceeds as set out in the Company's prospectus from its global offering and placement in November 2002, remains unchanged.

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Summary financial information

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

Results

	Years ended December 31,				
	2000 RMB'000	2001 RMB'000	2002 RMB'000	2003 RMB'000	2004 RMB'000
	(notes)	(notes)	(notes)	(notes)	(notes)
Turnover	2,178,449	2,365,566	2,725,782	3,062,255	3,824,029
Other revenues	3,196	20,996	4,600	11,720	23,488
Operating expenses					
Depreciation of property, plant and equipment	(377,894)	(383,037)	(552,523)	(594,003)	(666,971)
Employee compensation costs	(309,791)	(455,480)	(462,293)	(513,098)	(640,153)
Repair and maintenance costs	(246,230)	(235,003)	(152,693)	(172,139)	(226,733)
Consumption of supplies, materials, fuel, services and others	(719,617)	(793,213)	(836,460)	(924,412)	(1,230,070)
Operating lease expenses	(33,466)	(32,006)	(61,522)	(121,526)	(186,828)
Other operating expenses	(76,189)	(78,330)	(139,394)	(165,533)	(166,549)
Other selling, general and administrative expenses	(22,765)	(21,903)	(42,475)	(33,489)	(38,045)
Provision for impairment of property, plant and equipment	(30,800)	(38,000)	-	-	-
Total operating expenses	(1,816,752)	(2,036,972)	(2,247,360)	(2,524,200)	(3,155,349)
Profit from operations	364,893	349,590	483,022	549,775	692,168
Finance costs					
Exchange gain/(losses), net	277	(561)	(973)	(716)	199
Interest expenses	(6,340)	(9,373)	(5,289)	-	-
Interest income	30,505	28,125	11,216	32,175	34,300
	24,442	18,191	4,954	31,459	34,499
Share of profits of jointly-controlled entities	30,961	47,837	42,600	48,932	99,196
Share of loss of an associate	(33,781)	(3,434)	-	-	-

Summary financial information continued

Results continued

	Years ended December 31,				
	2000	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
	(notes)	(notes)	(notes)	(notes)	(notes)
Profit before tax	386,515	412,184	530,576	630,166	825,863
Tax	(99,659)	(139,106)	(176,190)	(164,260)	(124,136)
Net profit from ordinary activities attributable to shareholders	286,856	273,078	354,386	465,906	701,727

Assets and liabilities

	As at 31 December,				
	2000	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
	(notes)	(notes)			
Total assets	4,518,434	5,030,062	7,957,532	8,231,055	9,140,820
Total liabilities	(1,793,992)	(2,095,057)	(1,776,937)	(1,685,919)	(2,076,144)
	2,724,442	2,935,005	6,180,595	6,545,136	7,064,676

Notes:

1. The results of the Group for each of the two years ended 31 December, 2001, and assets and liabilities as at 31 December 2000 and 2001 presented above were extracted from the Company's prospectus dated 11 November 2002 .
2. The results of the Group for the year ended 31 December 2002, and assets and liabilities of the Group as at 31 December 2002 presented above have been extracted from the pro forma combined profit and loss account and consolidated balance sheet.
3. The results of the Group for each of the three years ended 31 December 2002, and the assets and liabilities of the Group as at 31 December 2001, 2000 and 1999 have been prepared on a pro forma combined basis as if the current Group structure had been in existence since 1 January 1999.

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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 14 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 pre-emptive rights under the Company's articles of association or the Company Law of the PRC which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Purchase, redemption or sale of listed securities of the Company

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

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 27 to the financial statements and in the consolidated statement of changes in equity.

Distributable reserves

At 31 December 2004, in accordance with the PRC Company Law, an amount of approximately RMB1,976 million standing to the credit of the Company's capital reserve account and an amount of approximately RMB206 million standing to the credit of the Company's statutory reserve funds (details of which are set forth in note 27 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 27 to the financial statements, the Company had retained profits of approximately RMB629 million available for distribution as dividends.

Save as aforesaid, the Company did not have any reserves available for distribution to its shareholders as at 31 December 2004.

Charitable contributions

During the year, the Group made charitable contributions totalling RMB 206,000.

Major customers and suppliers

In the year under review, sales to the Group's five largest customers accounted for 84% of the total sales for the year and sales to the largest customer included therein amounted to 64%. Purchases from the Group's five largest suppliers accounted for 24% of the total purchases for the year.

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

Directors and supervisors

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

Executive directors:

Yuan Guangyu	Appointed on 20 September 2002
Wu Mengfei	Appointed on 27 May 2004

Non-executive director:

Fu Chengyu	Appointed on 31 October 2003
Wang Zhongan	Appointed on 20 September 2002

Independent non-executive directors:

Gordon C. K. Kwong	Appointed on 30 October 2002
Andrew Y. Yan	Appointed on 20 September 2002
Simon X. Jiang	Appointed on 27 May 2004

Supervisors:

Liu Shoude	Appointed on 20 September 2002
Tu Zhimin	Appointed on 20 September 2002
Zhang Benchun	Appointed on 20 September 2002

Independent Supervisors:

Zhang Dunjie	Appointed on 27 May 2004
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In accordance with the Company's articles of association, all directors and supervisors are elected to a term of three years and may serve consecutive terms upon re-election.

The re-appointment of the existing directors, Mr. Fu Chengyu, Mr. Yuan Guangyu, Mr. Andrew Y. Yan and Mr. Gordon C. K. Kwong, and the existing supervisor, Mr. Zhang Benchun will be proposed at the forthcoming annual general meeting. Biographical details of the existing directors and supervisor who are proposed to be re-appointed are set out on pages 36 to 39 of the Annual Report.

Mr. Xiao Jianwen, aged 56 will be proposed to be the new supervisor. Mr. Xiao graduated from College of Economy of Beijing with a Bachelor's Degree. Mr. Xiao joined CNOOC in 1984, and he has served as one of supervisors in the Assets Management Department of CNOOC since 2003.

The appointment will be for an initial term of 3 years and Mr. Xiao's remuneration will be determined by the board. Mr. Xiao does not have any interest in the Group within the meaning of the Securities and Futures Ordinance. Other than Mr. Xiao's position in CNOOC, Mr. Xiao has no relationship with the directors and other senior management of the Group.

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.

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Directors' 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. Details of the directors' remunerations of year 2004 are set out in note 7 to the financial statements.

Apart from the foregoing, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Directors' and supervisors' interests in contracts

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

Contracts of significance

The Company has entered into several agreements with CNOOC Limited, a fellow subsidiary of the Company, and CNOOC Group other than CNOOC Limited, for the provision of oilfield services by the Company to CNOOC Limited and CNOOC Group, and for the provision of various services by CNOOC Group to the Company. Further details of the transactions undertaken in connection with these contracts during the year are included in note 31 to the financial statements.

Same as disclosed, no contracts of significance in relation to the Group's business to which the company or any of this subsidiaries was a party, and in which a director of the company had a material interest, which directly or indirectly subsisted as the year end or at any time during the year.

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

As at 31 December 2004, none of the directors, chief executive and supervisors and their respective associates had an interest or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations which would be required to be notified to the company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance (the "SFO") or which would be required, pursuant to Section 352 of the SFO, to be entered into the register referred to therein 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.

Substantial shareholders' and other persons' interests in shares

As at 31 December 2004, so far as is known to any director, or the chief executive, 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 Section 336 of the SFO:

Name	Notes	Capacity and nature of interest	Number and Class of shares (note a)	Approximate percentage in the same class of shares	Approximate percentage of issued share capital
China National Offshore Oil Corporation		Beneficially owned	2,460,468,000(L) domestic shares	100.00%	61.58%
J.P. Morgan Chase & Co.			197,554,100(L) H shares	12.87%	4.94%
		(note b)	190,973,100(P) H shares	12.44%	4.78%
The Capital Group Companies, Inc		Investment manager	164,842,925(L) H shares	10.74%	4.13%
Schroder Investment Management North America Limited		Investment manager	79,706,000(L) H shares	5.19%	1.99%

(a) "L" denotes long position and "P" denotes lending pool

(b) 1,374,000 H shares were held as beneficial owner, 5,207,000 H shares were held as investment manager and 190,973,100 H shares were held as custodian corporation/approved lending agent.

Save as disclosed above, the directors are not aware of any other person who 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 Hong Kong Stock Exchange ("HKSE") on 20 November 2002, transactions between the Group and its connected persons or their respective associates (as the respective terms are defined in the HKSE Listing Rules) are governed by and are required to comply with the requirements of the HKSE Listing Rules. During the year ended 31 December 2004, the Group had the following connected transactions:

	2004 RMB'000
A. Gross revenue earned from provision of services to the following related parties:	
a. CNOOC Limited Group	
Provision of drilling services	832,246
Provision of well services	545,108
Provision of marine support and transportation services	405,560
Provision of geophysical services	349,354
	2,132,268
b. CNOOC Limited Group as operator under production sharing contracts	
Provision of drilling services	223,661
Provision of well services	79,444
Provision of marine support and transportation services	56,110
Provision of geophysical services	940
	360,155
c. CNOOC Group (including services provided by China Nanhai-Magcobar Mud Corporation Ltd. ("Magcobar"))	
Provision of drilling services	67,967
Provision of well services	38,108
Provision of marine support and transportation services	102,371
Provision of geophysical services	3,461
	211,907
d. Jointly-controlled entities	
Provision of drilling services	3,207
Provision of well services	26,528
	29,735

Connected transactions continued

	2004 RMB'000
	(notes)
B. Included in operating expenses (including services provided to Magcobar)	
Services provided by the CNOOC Group:	
Labour services	16,962
Materials, utilities and other ancillary	106,099
Transportation services	3,798
Lease of office, warehouse, and berths	25,312
Lease of equipment	19,532
Repair and maintenance services	26,096
Management services	28,320
	226,119
C. Deposits placed with CNOOC Finance Company at 31 December 2004	411
D. Interest income earned from deposits placed with CNOOC Finance Company	4,495

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 of the HKSE Listing Rules in respect of the connected transactions set out above.

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.

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Code of Best Practice

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

Audit committee

The final results have been reviewed by the audit committee of the Board which consists of three independent non-executive Directors. The committee has reviewed the accounting principles and practices adopted by the Company, and has also discussed auditing, internal control and financial reporting matters including the review of audited 2004 annual results with the management. Since the listing of the Company's shares on 20 November 2002, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of the HKSE.

Auditors

The accounts have been audited by Ernst & Young who retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

ON BEHALF OF THE BOARD

Fu Chengyu

Chairman

Hong Kong
30 March 2005