

REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements of the Company and its subsidiaries (here in after collectively referred to as the 'Group') for the year ended 31 December 2005.

Principal activities

The Company is principally engaged in the provision of offshore oilfield services including drilling services, well services, marine support and transportation services, and geophysical services. The principal activities of the subsidiaries comprise investment holding, sale of logging equipment and leasing of geophysical vessels and provision of drilling services in Indonesia. 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 2005 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages [52 to 57].

A special interim dividend of RMB1.39 cents per ordinary share, amounting to a total of RMB56 million was paid to the shareholders in November 2006. The directors recommend the payment of a final dividend of RMB4.11 cents per share in respect of the year to shareholders whose names appear on the register of members on 25 May 2006. This recommendation has been incorporated in the financial statements as an allocation of retained earnings within the equity section of the balance sheet. This dividend together with the special interim dividend payment amounts to a total of about RMB220 million. Further details of this accounting treatment are set out in note 12 to the financial statements.

Subsidiaries

Particulars of the Company's subsidiaries as at 31 December 2005 are set out in note 15 to the financial statements.

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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

	Year ended December 31				
	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000 (notes)	2001 RMB'000 (notes)
Turnover	4,788,792	3,824,029	3,062,255	2,725,782	2,365,566
Other revenues	12,919	23,488	11,720	4,600	20,996
Operating expenses					
Depreciation of property, plant and equipment	(755,676)	(666,971)	(594,003)	(552,523)	(383,037)
Employee compensation costs	(833,345)	(640,153)	(513,098)	(462,293)	(455,480)
Repair and maintenance costs	(285,166)	(226,733)	(172,139)	(152,693)	(235,003)
Consumption of supplies, materials, fuel, services and others	(1,696,796)	(1,230,070)	(924,412)	(836,460)	(793,213)
Operating lease expenses	(213,436)	(186,828)	(121,526)	(61,522)	(32,006)
Other operating expenses	(105,288)	(166,549)	(165,533)	(139,394)	(78,330)
Other selling, general and administrative expenses	(61,737)	(38,045)	(33,489)	(42,475)	(21,903)
Provision for impairment of property, plant and equipment	-	-	-	-	(38,000)
Total operating expenses	(3,951,444)	(3,155,349)	(2,524,200)	(2,247,360)	(2,036,972)
Profit from operations	850,267	692,168	549,775	483,022	349,590
Financial income					
Exchange gains/(losses), net	(16,802)	199	(716)	(973)	(561)
Interest expenses	(104)	-	-	(5,289)	(9,373)
Interest income	16,956	34,300	32,175	11,216	28,125
	50	34,499	31,459	4,954	18,191
Share of profits of jointly-controlled entities	106,617	79,445	38,663	28,384	39,750
Share of loss of an associate	-	-	-	-	(3,434)
Profit before tax	956,934	806,112	619,897	516,360	404,097
Tax	(135,938)	(104,385)	(153,991)	(161,974)	(131,019)
Net profit from ordinary activities attributable to shareholders	820,996	701,727	465,906	354,386	273,078

Summary financial information continued

Assets and liabilities

	Year ended December 31				
	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000 (notes)	2001 RMB'000 (notes)
Total assets	9,663,962	9,140,820	8,231,055	7,957,532	5,030,062
Total liabilities	(2,009,220)	(2,076,144)	(1,685,919)	(1,776,937)	(2,095,057)
	7,654,742	7,064,676	6,545,136	6,180,595	2,935,005

Notes:

1. The results of the Group for the year 31 December, 2001, and assets and liabilities as at 31 December 2001 presented above have been extracted from the Company's Prospectus dated 11 November 2002 when the listing of the Company's shares was sought on the HKSE.
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.

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 we nor our subsidiaries purchased, disposed of or redeemed any of our listed securities during 2005.

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.

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Distributable reserves

As at 31 December 2005, 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 RMB329 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 RMB1,144 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 2005.

Charitable contributions

During the year, the Group made charitable contributions totalling RMB263,000.

Major customers and suppliers

In the year under review, sales to the Group's five largest customers accounted for 81.33% of the total sales for the year and sales to the largest customer included therein amounted to 63.18%. Purchases from the Group's five largest suppliers accounted for 19.51% 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
Wu Mengfei

Non-executive director:

Fu Chengyu
Wang Zhongan
Resigned on 19 September 2005

Independent non-executive directors:

Gordon C.K. Kwong
Andrew Y. Yan
Simon X. Jiang

Independent Supervisors:

Zhang Dunjie

Supervisors:

Liu Shoude
Resigned on 19 September 2005
Tu Zhimin
Resigned on 19 September 2005
Zhang Benchun
Xiao Jianmin
Appointed on 20 September 2005
Tang Daizhi
Appointed on 20 September 2005

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.

The Company having received annual confirmations of independence pursuant to Rule 3.13 of the Mainboard Listing Rules from Gordon C.K. Kwong, Andrew Y. Yan, Simon X. Jiang and Zhang Dunjie, as at the date of this report, still considers them to be independent.

Directors, Supervisors and Senior Management

Biographical details of the directors and supervisors of the Company and the senior management of the Group are set out on pages [39 to 40] of the Annual Report

Directors and supervisors service contracts

Each of the independent non-executive directors and independent supervisors is required to enter into a service contract with the Company for a term of three years, renewable upon re-election. Details of the directors remunerations for the year 2005 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 remuneration

Directors and supervisors fees are subject to shareholders approval at general meetings. Other emoluments are determined by the Company's board of directors with reference to directors duties, responsibilities, the remuneration committee and the performance and results of the Group.

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.

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

Directors, chief executives and supervisors interests and short positions in shares

As at 31 December 2005, none of the directors, chief executive and supervisors and their respective associates had registered an interest or short positions in the shares of the Company or any of its associated corporations that was required to be recorded pursuant to Section 352 of the Securities and Futures Ordinance (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 Issuers.

Directors, chief executives 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 spouses or minor children, or were any such rights exercised by them; nor 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.

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Substantial shareholders' and other persons' interests in shares

As at 31 December 2005, so far as is known to any director, or the chief executive, the following interests of 5% or more in the issued share capital or H 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 (note a)	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(L) domestic shares	100.00%(L)	61.58%(L)
The Capital Group Companies, Inc	Interest in a controlled corporation (note b)	181,918,925(L) H shares	11.85%(L)	4.55%(L)
SKAGEN Kon-Tiki Verdipapirfond	Interest in a controlled corporation (note c)	78,236,000(L) H shares	5.10%(L)	2.00%(L)

Note (a): "L" denotes long position.

Note (b): The direct beneficial owners are Capital Research and Management Company holding 122,347,000 H shares, and Capital International, Inc. holding 59,571,925 H shares. Both direct beneficial owners are 100% controlled corporations of The Capital Group Companies, Inc.

Note (c): The direct beneficial owner is Stavanger Fondsforvaltning AS, a controlled corporation of SKAGEN Kon-Tiki Verdipapirfond.

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.

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 by 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 2005, the Group had the following connected transactions:

	2005 RMB'000
A. Gross revenue earned from provision of services to the following related parties:	
a. CNOOC Limited Group	
Provision of drilling services	1,498,929
Provision of well services	772,070
Provision of marine support and transportation services	527,149
Provision of geophysical services	346,033
	3,144,181
b. CNOOC Group (including services provided by China Nanhai-Magcobar Mud Corporation Ltd. ("Magcobar"))	
Provision of drilling services	2,447
Provision of well services	222
Provision of marine support and transportation services	80,468
Provision of geophysical services	8,416
	91,553
c. Jointly-controlled entities	
Provision of drilling services	1,665
Provision of well services	11,182
Provision of marine support and transportation services	10
	12,857
B. Included in operating expenses (including services provided to Magcobar)	
Services provided by the CNOOC Group:	
Labour services	11,383
Materials, utilities and other ancillary services	166,139
Transportation services	3,028
Lease of office, warehouse, and berths	29,739
Repair and maintenance services	10,256
Management services	29,636
	250,181
C. Deposits placed with CNOOC Finance Company at 31 December 2004	103
D. Interest income earned from deposits placed with CNOOC Finance Company	-
E. Purchase of items of property, plant and equipment from the CNOOC Group	11,688

For items (A) to (B) above, pursuant to ordinary resolutions passed at the Adjourned Extraordinary General Meeting of the Company held on 29 November 2004, the independent shareholders have granted approval for the Company to enter into the connected transactions set out above.

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Connected transactions continued

For items (C) and (D), these transactions were qualified as "De minimis transactions" as defined in the Listing Rules. In respect of item E above, such purchase were announced in accordance with Chapter 14A of the Listing Rules on 14 December 2005. The transaction amounting to approximately RMB11,688,000 was entered into on 12 December 2005 between the Company and China Offshore Oil International Engineering Company (the "Vendor"), a company established in the PRC and a fellow subsidiary of CNOOC. The transaction involved the purchase of certain office equipment, machinery, properties and vehicles. The purchases were made with a view to reduce the amount of recurring connected transactions between the Company and CNOOC Group and also to reduce the operating costs of the Company in the long run. Pursuant to this transaction the Company will cease to lease the assets acquired from Vendor.

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 approved by the independent shareholders.

Sufficiency of public float

Based on information that is publicly available to the Company and within the knowledge of the directors, at least 25% of the Company's total issued share capital was held by the public as at the date of this report.

Post balance sheet events

Details of significant post balance sheet events of the Group are set out in note 33 to the financial statements.

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 2005 annual results with the management.

Code on Corporate Governance Practices and Model Code for Securities Transactions by Directors of Listed Issuers

For the year under review, compliance with the Code on Corporate Governance Practices by the Company is set out in the Corporate Governance Report on page 33 to 37 of this annual report. Upon specific enquiry to each and every director by the Company, the Board of Directors confirms that all the numbers of the Board, for the year under review, have complied with the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 of the Listing Rules.

Auditors

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

ON BEHALF OF THE BOARD

Fu Chengyu

Chairman

Hong Kong

22 March 2006