MANAGEMENT DISCUSSION & ANALYSIS

INDUSTRY REVIEW

2006 Worldwide Rig Count

3,043

platform

2006 Rig Count Increased

10.8%

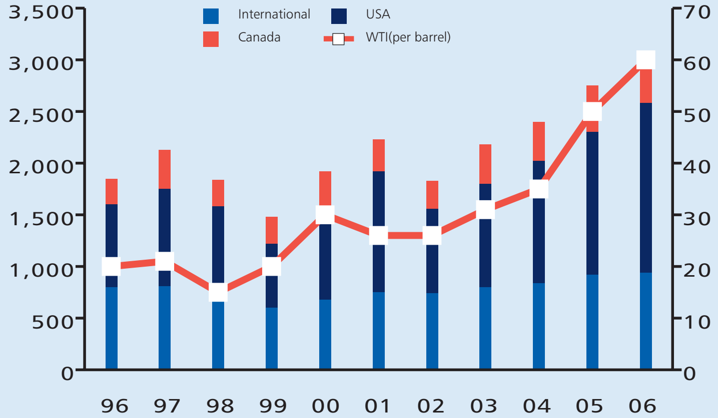
from 2,746 in 2005

Sources: BakerHughs website

The global economy continued to thrive in 2006, growing by 5.1%, which is higher than the 4.9% recorded in 2005. As a result, with an average growth rate of 4.8%, the last four years represented a period of fastest growth for global economy since the 1970s. The continued high growth rate for global economy in 2006 was mainly due to the robust growth of the developed countries in the first quarter, as well as continued high rate of growth of the major developing economies such as China and India. For the past decade, China's economy has sustained remarkable growth, with an average GDP growth rate of 8.6%. In 2006, China's GDP increased by 10.7%, mark-up a record high for the country's economic growth.

Economic growth has spurred the demand for energy. OPEC statistics show that global consumption of oil has increased by 1.2% in 2006, driven by global economic growth. Meanwhile, international oil prices remain at a high level, despite a drop following earlier rises. In the first half of the year, oil prices followed the upward trend in the past three years. and the West Texas Intermediate (WTI) averaged at US$67.1 per barrel. In the latter half of the year, oil prices began to drop from August onwards after peaking at US$77.03 per barrel in July. At year end, oil price was at US$56.0 per barrel. WTI averaged at US$60.3 per barrel throughout 2006, representing an increase of 21% year-on-year which was slower than the 44% posted in 2005.

Recent 10-year Rig Count and Oil Prices Trend



Sources: Baker Hughes Incorporated rig count information

MANAGEMENT DISCUSSION & ANALYSIS

Increasing oil prices over a sustained period have effectively led to high growth rate in the investment in exploration and production (E&P) by major oil companies. OPEC statistics show that the global investment in oil E&P has increased twofold from approximately US$110 billion in 1999 to around US$220 billion in 2006. CNOOC Limited, a leader in oil E&P offshore China and our principal customer, attained a compound growth rate in E&P investment year by year in the past five years.

The sustained growth of global E&P investment over the past 7 years has presented unprecedented room for expansion to the oilfield service industry. Supply of drilling platforms cannot meet demand in the global market. Drilling day rate is thus driven higher. Statistics of Baker Hughes show that there was a total of 3,043 drilling platforms around the world in 2006, 297 more than the 2,746 drilling platforms in 2005, representing a rise of 10.8%. Regions with the most substantial growth are the United States and Canada.

The oilfield services industry not only faced a shortage of equipment like drilling rigs in 2006, but also experienced and exacerbated shortage of talented human resources. Some companies made use of the booming period for the industry and abundant cash flow to reorganize their businesses and integrate their resources, or expand internationally through acquisition. At the same time, technological breakthrough, human resource management, innovate business mode and capital deployment have gradually become focuses of attention in the industry.

Apart from drilling services, COSL offers a full range of other oilfield services, including well services, marine support and transportation services as well as geophysical services, spanning each phase of the exploration, development and production process. The technology-centered strategy, cost leadership strategy, integrated project management and internationalization strategy are the four core strategies of COSL's long-term development. We will continue to synergize and integrate our services so as to provide more efficient and effective services to our clients.

Drilling Services

2006
Drilling Revenue

3,100.4
RMB Million

2006
Drilling Revenue
Increased

40.6%
from RMB 2,205.7 Million

COSL is the leading drilling services provider in the offshore China market. We operate a fleet of 15 drilling rigs, including 12 jack-up rigs and 3 semi-submersible rigs, 1 of jack-up rigs was leased.

In 2006, we drilled a total of 221 wells, including 56 exploration wells and 165 development wells.

COSL941, China's first 400-feet jack-up rig commenced operation in 2006 and later operated in the Western part of Nanhai Gulf. It has greatly enhanced COSL's operation capacity and international competitive advantages.

Other than upgrading the drilling capacity, COSL has also actively expanded new businesses. We have obtained contracts for module rigs in Mexice and liftboat. These new businesses will add further impetus to our future revenue growth.

The management contract for the sixth generation drilling rig in Iran created a new drilling rig service mode for us and reached a new stage from managing our own drilling rigs to managing those of our clients.

MANAGEMENT DISCUSSION & ANALYSIS

BUSINESS REVIEW

COSL941 in Operation

COSL 941 delivered with high-tech and automatic system

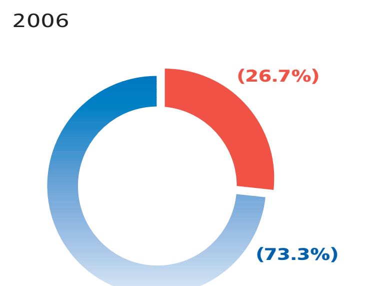
Global oil and natural gas exploration and production business remained robust in 2006. Building upon a sustained domestic market share of our drilling services business, we actively expanded into the overseas markets and achieved major breakthroughs. We have 2 semi-submersible rigs and 1 jack-up rig operating in Indonesia, Myanmar and Australia, respectively. Our quality services attracted many new overseas clients, including Daewoo E&P, Genting Oil Natuna Pte. Ltd., Medco Moeco Langsa Ltd. and Woodside.

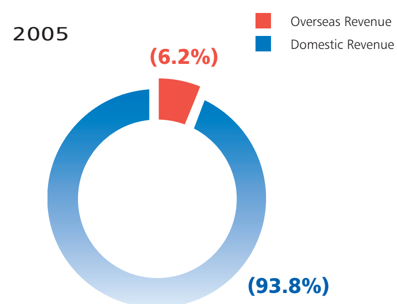
In 2006, turnover from our drilling business increased by 40.6% over the previous year, reaching RMB3,100.4 million. Overseas business contributed RMB827.4 million, representing 26.7% of the total turnover. Meanwhile, COSL941, China's first 400-feet cantilever jack-up rig commenced operation on 25 June 2006 in Beibu Gulf. Its operation record throughout the year was promising.

As of 31 December 2006, we operated a total of 15 drilling rigs (including 1 leased rig). Of these rigs, 8 were located in the Bohai Bay, China, 4 were located in the South China Sea, 2 were located in offshore Indonesia and 1 at offshore Australia. During the year, we drilled a total of 221 wells, of which 56 were exploration wells and 165 were development wells. Of the wells drilled, 168 were in the Bohai Bay, China, 36 were in South China Sea and 17 were located overseas.

In 2006, our drilling rigs operated a total of 824 and 3,945 days overseas and in China respectively. These added up to a total of 4,769 operating days, up by 165 days compared to the 4,604 days in 2005. Jack-up rigs contributed 100 days to the increase (an increase of 210 days for domestic operations and a decrease of 110 days for overseas operations). The increase was mainly attributable to the total 179 operating days for COSL 941, which commenced operation on 25 June 2006. In addition, as contracts followed closely one after another and the market condition

Overseas' Drilling Revenue Contribution for Drilling Services





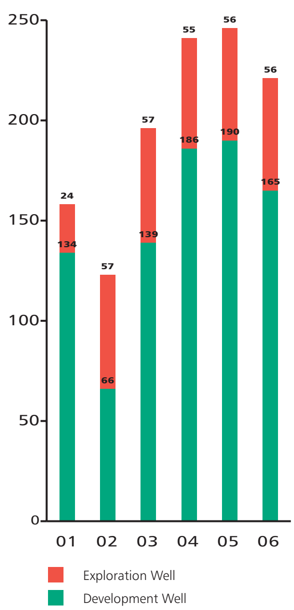
MANAGEMENT DISCUSSION & ANALYSIS

was favourable, the total number of days in operation increased by 42 days. Nevertheless, in accordance with the annual repair and maintenance plan, days for maintenance increased by 131 days over 2005, (including 10 days for the maintenance of COSL 941). Semi-submersible rigs had 65 more operating days (resulting from a decrease of 465 days for domestic operation and an increase of 530 days for overseas operation). The increase was mainly derived from fewer days lost between contracts, which contributed to an increased in operation days by 53 days. Moreover, maintenance days according to the repair and maintenance plan were reduced by 12 days from the previous year. In 2006, the average calendar day utilization rate was 90.0%, same as that in 2005. Utilization rates for jack-up rigs and semi-submersible rigs were 91.3% and 84.9% respectively. The available day utilization rate reached 100%, compared to 98.0% of the same period last year. Both jack-up rigs and semi-submersible rigs achieved an utilization rate of 100% as to available days.

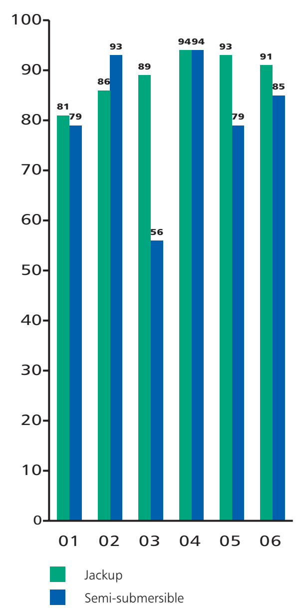
Average day rate for our rigs was US$67,830/day, which represented a 55.8% increase from US$43,542/day in 2005. Of the increase, the average day rate for jack-up rigs was US$55,559/day, which represented a 37.5% increase from US$40,405/day in 2005. Average day rate for semi-submersible rigs was US$118,483/day, up by 107.5% from US$57,098/day in 2005.

In addition, we achieved more outstanding development in well workover in 2006. We completed an aggregate of 13,369 team days in well workover operations up by 57.6% from 8,483 team days in 2005. The increase was mainly due to the provision of integrated well workover, service to CNOOC SES Ltd. in Indonesia.

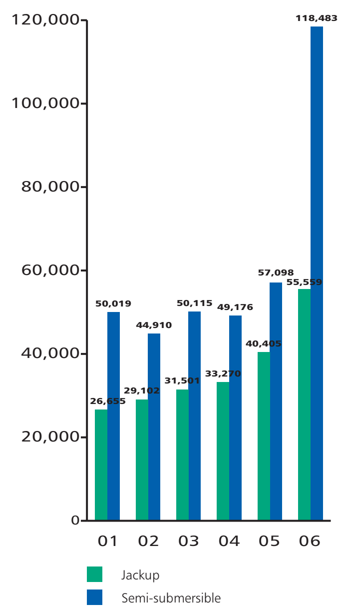
No. of Well Drilled



Utilization Rate (%)



Dayrate (USD/Day)



MANAGEMENT DISCUSSION & ANALYSIS

In order to expand our operation capacity, we commenced construction of the second 400-feet jack-up rig (COSL 942) on 14 July 2005. We implemented modification of the design jointly with Dalian New Shipbuilding Heavy Industry Co., Ltd. The rig is currently in the construction stage, and is expected to be completed in the first half of 2008. In addition, we secured a contract with PEMEX in Mexico for four module rigs, which are expected to commence operation in the second quarter of 2007. In December, we entered into a construction agreement with China Merchants Heavy Industry Co., Ltd. in relation to the construction of two liftboats. The liftboats to be constructed will feature those functions including well workover, adjustment well drilling, crushing, acidification, continuous oil pipe operation and development operation of marginal oilfield. Once completed and operation commenced, the project will systematically alter the mode of oilfield development operation. It will further enhance our cooperation with our clients in oilfield services.

COSL941, China's first 400-feet jack-up rig commenced operation on May 31, 2006 and later operated in the Western part of Nanhai Bay. It has greatly enhanced COSL's drilling capacity and international competitive advantages

In order to meet the robust market demand, the Company has commenced the construction of COSL942, which is expected to be delivered in the first half year 2008.

Being invented, designed, constructed, installed, operated and managed by COSL, the four module rigs used for Mexico Project has a china made rate of 92%, setting many domestic records. COSL's high project management efficiency has reached the international standards and set new record in the construction cycle. The commencement of the project enabled us to enter the traditional market of oil services in the Gulf of Mexico market. It is expected that the four module rigs will commence operation in the second quarter, 2007.

Well Services

2006
Well Services Revenue

1,352.2

RMB Million

2006
Well Services Revenue
Increased

16%

from RMB 1,165.3 Million
over 2005

COSL is an experienced well services provider, with over 30 years of experiences in offshore China market, and more than 20 years of experiences in onshore market. We provide one-stop well services, including wire logging, drilling fluids, directional drilling, cementing, well completion, well work-over services and information integration services. COSL is particular competitive in drilling fluids and cementing services in the international markets.

In addition, we put strong efforts on research and development. Not only do we own a lot of advanced equipment, also have a fleet of qualified management team. We can provide comprehensive onshore and offshore drilling and development oil services for both domestic and international clients. COSL has already entered a number of international markets, such as the Philippines, Indonesia, Myanmar and Papua New Guinea.

On 16 January, COSL won in an international tender and has secured three new oilfield service contracts for pre-drilling, drilling fluid and cementing operations in M (Onshore) block with CNOOC Myanmar Limited ("CML"). These pre-drilling and drilling fluid contracts are the first overseas projects of the kind under well services segment secured by the Company. The total amount of the 3 contracts reached RMB40 million

On 27 July, COSL has signed a well cementing services contract with Sinopec International Petroleum Exploration and Production Corporation for the provision of well cementing services to its Sakhalin-Veninsky project in Russia. It is the first overseas contract between COSL and Sinopec

The Company's self-developed Enhanced Logging Imaging System (ELIS) has begun to gain market recognition in domestic market and Middle East market

The FCT system has received the certificate from National Technology Department and has experienced operation testing in Bohai

MANAGEMENT DISCUSSION & ANALYSIS

Well services benefited from the continuous active exploration and development offshore China and expansion into overseas markets in 2006. As our well services business solidified its position in the domestic market, we also actively expanded our well services into new overseas markets including the Philippines, Indonesia, Myanmar and Papua New Guinea. Turnover from well services amounted to RMB1,352.2 million in 2006, compared to RMB1,165.3 million in 2005, representing an increase of RMB186.9 million, or 16.0%.

Logging We completed 837 logging trips in 2006, an increase of 139 trips, or 19.9%, from 698 trips in 2005. Turnover from logging services amounted to RMB290.5 million, a 34.9% increase compared to 2005. The increase in turnover was mainly attributable to the utilization of COSL's self-developed Enhanced Logging Image System (ELIS), as well as the expansion in the new markets of Conoco Phillips exploration wells and logging of development wells in the Bohai area, and the new market of open-hole logging in the ROC block. Open-hole logging operations in the Bohai area also increased.

Drilling Fluids In 2006, we offered drilling fluids services for 291 wells, down by 77 wells from the 368 wells in 2005. Turnover from drilling fluids services amounted to RMB308.6 million, an increase of 27.8% over 2005. The increase was mainly derived from the development of new service markets such as the Jidong oilfield and CML in Myanmar, and the utilization and application of the SBM-II drilling fluids technology, and other new technologies such as MB new drilling fluids and retrieval device for heavy crystals.

Directional Drilling In 2006, we performed directional drilling services on 242 wells, an increase of 32 wells from 210 wells in 2005. Turnover from directional drilling services in 2006 was RMB319.1 million, an increase of 23.3% from RMB258.7 million in 2005. The increase was mainly attributable to the development of new onshore market (Jidong oilfield) and the utilization of advanced equipment, such as the Logging While Drilling (LWD) system, pumping production and Reservoir Performance Monitor (RPM).

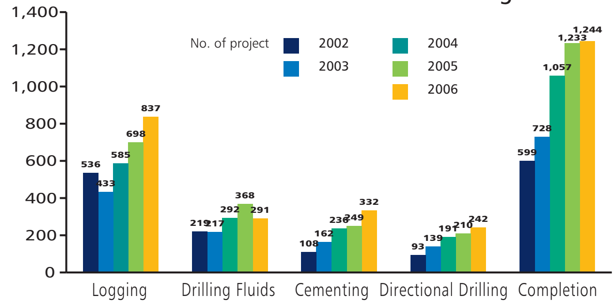
Cementing We completed cementing services on 332 wells in 2006, 83 more than the 249 wells completed in 2005. Turnover from cementing totaled RMB297.7 million in 2006, an increase of 53.9% from the RMB193.5 million in 2005. The increase was mainly attributable to the cementing services provided to the new Conoco Phillips Phase 2 project, Philippine National Oil Corporate, Sinopec project in Sakhalin-Veninsky, Russia and CNOOC Myanmar Limited. The application of new latex slurry technology and cementing technology also contributed to the turnover growth.

Well Completion We performed well completion on 1,244 wells in 2006, 11 more than the 1,233 wells in 2005. Turnover from well completion was RMB97.9 million in 2006, whereas turnover in 2005 was RMB90.0 million.

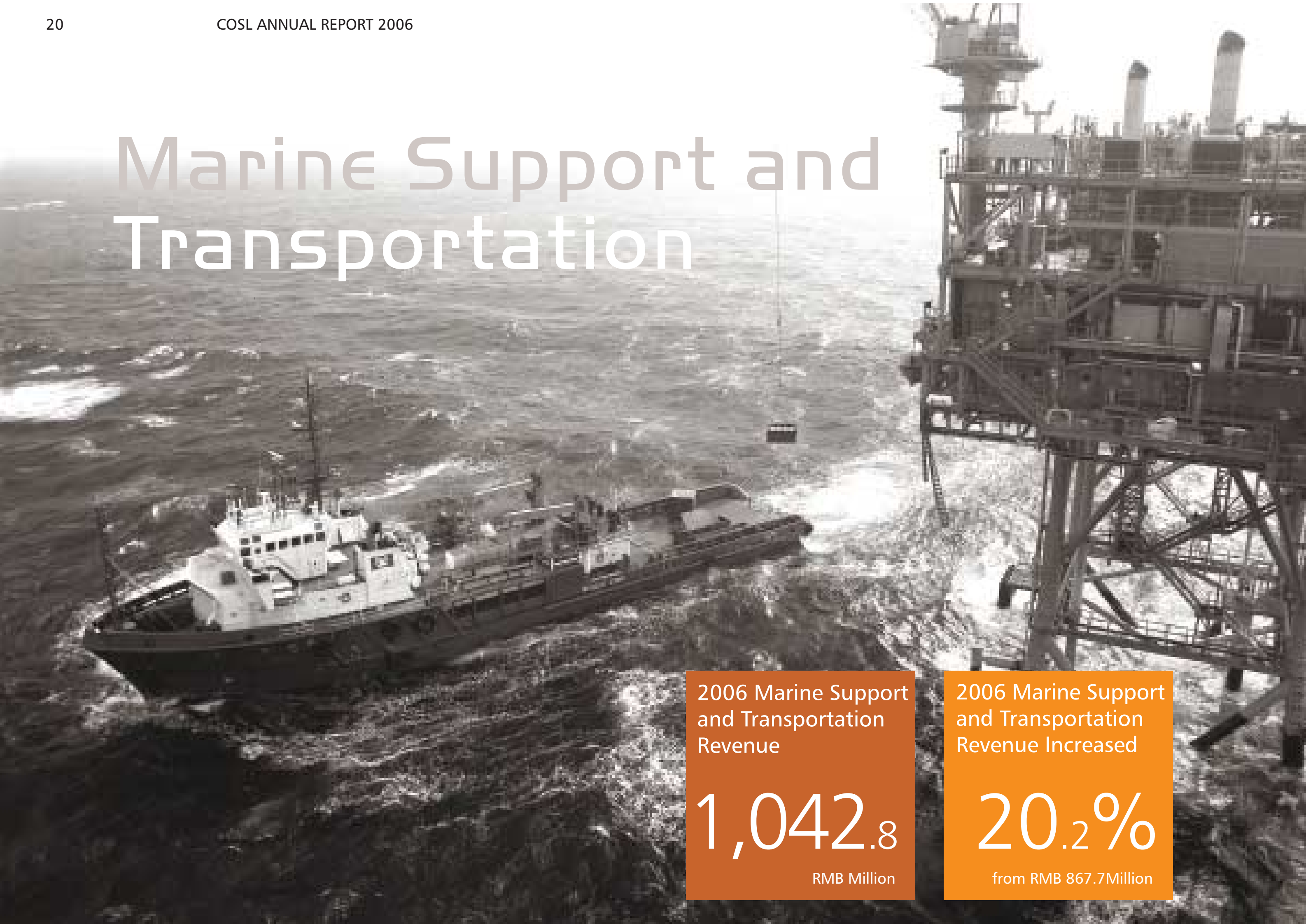
Other Oilfield Technology Services In 2006, turnover from other oilfield technology services amounted to RMB38.4 million, a decrease of RMB127.8 million or 76.9% from the RMB166.2 in 2005. The decrease was mainly due to a drop in the volume of trading of non self-produced materials.

COSL's logging services

Five Production Line in Well Services Segment



Marine Support and Transportation



2006 Marine Support and Transportation Revenue

1,042.8

RMB Million

2006 Marine Support and Transportation Revenue Increased

20.2%

from RMB 867.7Million

COSL owns and operates the largest and most diverse fleets in offshore China. As at 31 December, 2006, we own and operate 69 support vessels, 5 oil tankers, 1 chemical carrier. We also lease 5 working vessels and 5 chemical carriers.

Our vessels mainly operate the offshore China. We provide services to offshore oil and gas exploration, development and production in a number of ways, including supply, goods and crew transportation, tow and positioning for drilling platforms, as well as tow and anchor for offshore drilling rigs. Our oil tankers are used to transport crude and refined oil and gas products. The chemical carrier is used to transport chemical fluids like methanol.

In 2006, COSL partnered with Trico Marine to form a joint venture company, Eastern Marine Services Limited to expand marine services in Southeast Asia market.

In order to increase our capacity in marine support and transportation services, we commenced a shipbuilding plan for 18 marine support vessels which are expected to operate in the near future.

In November 2006, support vessel COSL 671 commenced operation, which has further upgraded our fleet.

MANAGEMENT DISCUSSION & ANALYSIS

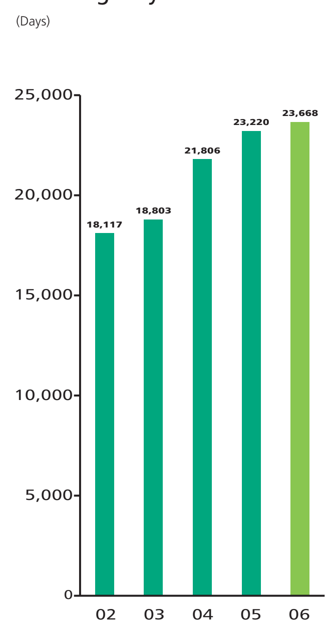
Our marine support and transportation services business continued its steady upward trend in 2006. While our self-owned vessels could not accommodate the increacsed volume of operations, we expanded our market share through operating leased vessels to maintain our leading position in the offshore China market. Turnover from marine support and transportation services in 2006 reached RMB1,042.8 million, up 20.2% from the RMB867.7 million in 2005. Annual total operating days rose from 23,220 days in 2005 to 23,668 days in 2006, representing an increase of 1.9%. The calendar day utilization rate was 95.1%, a 1.5% increase from 93.6% in 2005. Average day rate increased by 14.8%.

Gross transportation volume of oil tankers was 1,380,054 tons, a 6.3% decrease from 1,472,300 tons in 2005. Transportation volume of the chemical tanker reached 499,970 tons, a 739.0% increase over the 59,590 tons in 2005. The rise was brought along by new clients such as CNOOC Oil Base Group Limited's Huizhou oil products company and CNOOC Kingboard Chemical Limited.

In November 2006, the Company's new Anchor Handling, Towing and Supply (AHTS) vessel COSL671 commenced operation. At the same time, in order to further strengthen our leading position in the offshore China marine support vessels market, we commenced a shipbuilding plan for 18 marine support vessels in December. The 18 marine support vessels (4000-6500 kw) to be built constitute the largest construction project for our marine support and transportation services business in recent years. The project will not only improve the vessel age structure of the existing COSL fleet, but also lay a solid foundation for our business' expansion into international markets.

In addition, we established a joint venture with Trico Marine Services Inc. in the United States in 2006, namely Eastern Marine Services Ltd. The joint venture was registered in Hong Kong, mainly to provide services to the South East Asian market, one of our target overseas markets. The joint venture provides marine support services to offshore oil and natural gas exploration, production and relevant construction. The establishment of such joint venture is in line with our long-term strategy of strengthening our leading position as a provider of marine support services. By providing diversified quality marine support services to the vast South East Asian offshore market, our operation capacity will be further strengthened.

Working Days for Marine Vessles



Pic1: Eastablished Easter Marine Services Limited

Pic2: COSL's new chemical carrier

Geophysical Services

COSL is the dominant geophysical services provider in offshore China, also a major player in international markets. We own a fleet of 7 seismic vessels and 4 geotech survey vessels.

We also operate in other regions including the South and North Americas, the Middle East, offshore Africa and offshore Europe. Our geophysical services are divided into two main categories: seismic services and surveying services.

The commencement of operation of COSL 718 in March 2006 has marked the first 6-streamer dual-source seismic vessel modified in Asia.

We have put together the world's first-class geophysical equipment in COSL 718. It can operate multi streamers at one time, and has greatly upgraded our geophysical services. It provides strong support to COSL's future development in the geophysical area and enhances our operation efficiency.

The 4-streamer Binhai 512 has been modified and commenced operation, it is mainly engaged in 3D seismic data collection.

2006
Geophysical Services
Revenue

869.4

RMB Million

2006
Geophysical Services
Revenue Increased

58.1%

from RMB 550.0 Million
over 2005

Revenue contributed
from COSL 718

130.0

RMB Million

Revenue contributed
from BH 512

80.0

RMB Million

MANAGEMENT DISCUSSION & ANALYSIS

We are the dominant geophysical services provider in the offshore China market. We also operate in other regions including the South and North Americas, the Middle East, offshore Africa and offshore Europe. Our geophysical services are divided into two main categories: seismic services and surveying services. We own a fleet of 7 seismic vessels and 4 geotech survey vessels.

Seismic Services

With the sustained growth in energy demand in recent years, the geophysical market in offshore China has been robust. Demand for 3D seismic data is especially strong. our geophysical services experienced fast growth in 2006.

As the 6-streamer seismic vessel COSL 718 commenced operation in March and the renovation of 4-streamer Binhai 512 has been completed, our overall geophysical operation capacity was enhanced. With respect to seismic data collection, we collected 7,337 sq. kilometers of 3D seismic data and 45,682 kilometers of 2D seismic data. 3D seismic data increased by 3,644 sq. kilometers, or 98.7%, from 3,693 sq. kilometers in 2005, mainly because COSL 718 collected 2,486 sq. kilometers more 3D seismic data and Binhai 512 collected 906 sq. kilometers more 3D seismic data after their renovation. 2D seismic data decreased by 484 kilometers, or 1.0%, from 46,166 kilometers in 2005, mainly because Binhai 512 primarily collected 3D seismic data after 4-streamer renovation. As a result, the amount of 2D seismic data collected was less than 2005's figures.

In terms of data processing, we processed a total of 4,187 sq. kilometers of 3D seismic data in 2006, which was 1,344 sq. kilometers more than 2,843 sq. kilometers in 2005, representing an increase of 47.3%. 2D seismic data of 14,512 kilometers was processed, down by 1,234 kilometers, or 7.8%, from 15,746 kilometers in 2005.

Surveying Services

Turnover from surveying services in 2006 amounted to RMB232.3 million, an increase of RMB107.4 million or 86.0% from RMB124.9 million in 2005. RMB65.4 million in turnover generated by COSL709, which commenced operation in the second half of 2005, contributed to the majority of the increase.

1

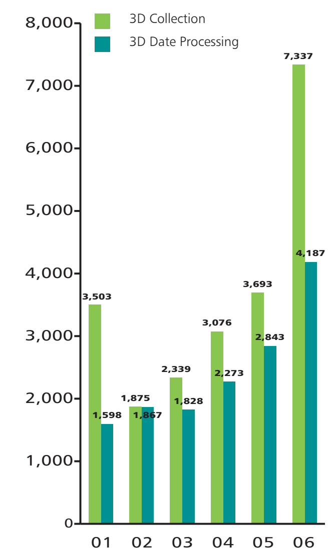
in March 2006, COSL 718 was upgraded and commenced operation, The operation efficiency of 3D seismic date rose nearly 90%

2

COSL successfully fulfilled seismic contract in "Sino-Philippine-Vietnam" Project.

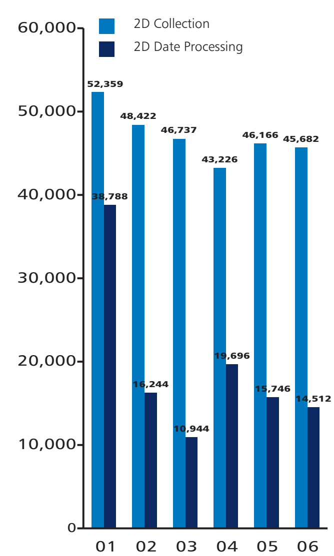
3D Collection and Data Processing

(KM^2)



2D Collection and Data Processing

(KM)



MANAGEMENT DISCUSSION & ANALYSIS

COSL could Provide IPM Services

2006 IPM Contributed

747.8

RMB Million

11.7%

Contribution in Total Revenue

Integrated Project Management

The Integrated Project Management is one of our core strategies. We benefited from our complete service chain and the superior capacity of our oilfield services equipment to provide comprehensive or bundled integrated service to our clients. We entered into 14 integrated contracts in 2006, 1 less than in 2005. Turnover realized from integrated services totaled RMB747.8 million, representing 11.7% of our gross revenue.

Technology and Development

Technological advancement is the ultimate fuel for elevating our long-term development. We have always regarded technological progress as our long-term developmental strategy. Our research and development efforts aim to solidifying core competencies and satisfy increased market demand, through our own propriatacy innovation and collaboration with others. In 2006, we were granted 31 patents. At year end of 2006 we were in possession of a total of 62 patents.

We achieved several breakthroughs in technological development in 2006. Formation Characteristics Tools (FCT) was certified by the Ministry of Science and Technology and was tested successfully on-site at the Bohai Oilfield. FET was finalized and industrial production has begun. ELIS-II imaging system, which was self-developed by as saw a key technological breakthrough as a successful system. High performance drilling fluids required in the tilted layer in Myanmar ensured that the exploration wells in Myanmar could be implemented smoothly. Nitrogen foam was tested with success on-site, and will soon be transformed into new service capacity. Sensors like APIL industrial and DFIT scientific machines reported initial success in the test at the Liaohe oilfield.

Pic1: ELIS gained recognition in domestic market and Middle-East market

Pic2: FCT was granted the certificate from National Technology Department

MANAGEMENT DISCUSSION & ANALYSIS

Overseas Business Expansion

We have achieved internationalization of our operations on a regional basis in 2006, with our overseas operations extending to 13 countries and regions including Indonesia, Myanmar, Australia, the Philippines and Mexico. Our turnover from overseas markets in 2006 amounted to RMB1,104.0 million, constituting 17.3% of our total turnover, and representing an increase of 151.4% over the RMB439.2 million in 2005.

Besides marketing a contribution to our well workover project in Indonesia and our B4 long-term contract, ELIS logging service has also entered the Middle East market. We secured a contract through open tender to provide senior Workover Pulling Unit management personnel for BR Energy in Malaysia. What is more important is that building on our experience gained and lessons learned, our overseas expansion has accelerated. As a result, we experienced further breakthroughs in our overseas business in 2006.

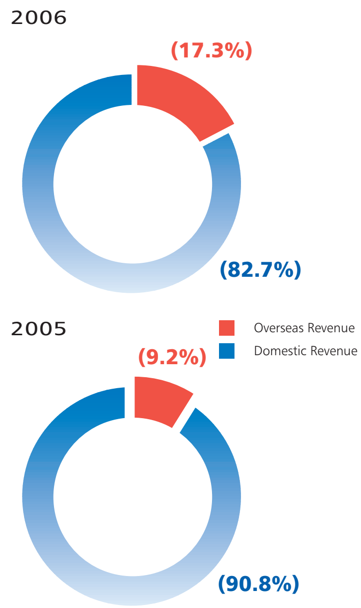
N2, a semi-submersible rig, executed three drilling operation contracts in Myanmar and Indonesia. with its reputation established, new clients are enquiring about opportunities for cooperation and the day rate has increased. Through working with Maersk, the semi-submersible rig N6 was sent to Australia to execute the Woodside drilling contract, entering the international high-end market of Shell Oil Company.

The commencement of the drilling rig management service project in Iran created a new drilling rig service model for us. From managing our own drilling rigs we have begun to manage those of our clients.

In addition, we obtained a contract for four module rigs of 7000 meters from PEMEX in Mexico, which has a domestic rig production rate of 92%, setting many domestic records. The commencement of the project enabled us to enter the market traditionally dominated by the European and American oil service companies, and to acquire a share in the Gulf of Mexico market, with a rich deposit of oil and gas.

As our drilling business expanded overseas, our cementing business also made great advancement in the overseas market, reaching to the Philippines, Indonesia, Myanmar and Papua New Guinea markets. The cementing business, as a relatively more competitive segment of our well services business, will gradually help bring our other businesses to the overseas market.

Overseas Revenue Contribution for COSL



Pic1: With successful overseas expansion, COSL has attracted more international employees

Pic2: The modle of module rigs of 7000 meters from PEMEX in Mexico

MANAGEMENT DISCUSSION & ANALYSIS

FINANCIAL REVIEW

In 2006, COSL continued to achieve strong growth, the Company's turnover for 2006 was RMB6,364.8 million, representing an increase of 33%, operating profit was RMB1,392.2 million, net profit was RMB1,128.2 million, increased by 64% and 37% respectively. Operating profit margin rose to 22%. In addition, we also achieved remarkable development in overseas markets, maintained a low financing cost at a high efficiency, recorded encouraging performance in the capital market, and further enhanced our equipment and technology......

2006 Revenue

6,364.8

RMB Million

Operating turnover Increased

32.9%

from RMB 4,788.8 Million

Turnover

Our turnover for 2006 was RMB6,364.8 million, representing an increase of RMB1,576.0 million or 32.9% from RMB4,788.8 million in 2005. The increase was driven by the expansion into overseas markets, increases in our service prices and use of new equipment. Meanwhile, turnover from our four business segments grew at different rates.

Turnover from drilling services reached RMB3,100.4 million in 2006, representing an increase of RMB894.7 million or 40.6% from RMB2,205.7 million in 2005. The increase in turnover was mainly attributable to a rise in the day rate of our drilling rigs and the commencement of operation of COSL941.

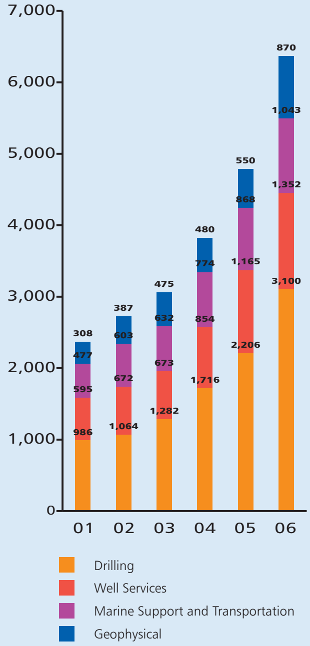
Turnover from well services reached RMB1,352.2 million in 2006, representing an increase of RMB186.9 million or 16.0% from RMB1,165.3 million in 2005. The increase in turnover was mainly attributable to an expansion into overseas markets and an increase in our operation volume.

Turnover from marine support and transportation services reached RMB1,042.8 million in 2006, representing an increase of RMB175.1 million or 20.2% from RMB867.7 million in 2005. The increase in turnover was mainly attributable to a rise in our service fees and volume of shipping of chemicals.

Turnover from geophysical services reached RMB869.4 million in 2006, representing an increase of RMB319.4 million or 58.1% from RMB550.0 million in 2005. The increase in turnover was mainly attributable to a rise in the volume of overseas 2D seismic data collection, the commencement of operation of COSL718 and renovation of Binhai 512.

Overall Revenue

RMB Million



MANAGEMENT DISCUSSION & ANALYSIS

Other Revenues

In 2006, other revenue totaled RMB31.3 million, representing an increase of 142.6% over the RMB12.9 million in 2005. The increase was mainly due to a rise in insurance compensation.

Operating Expenses

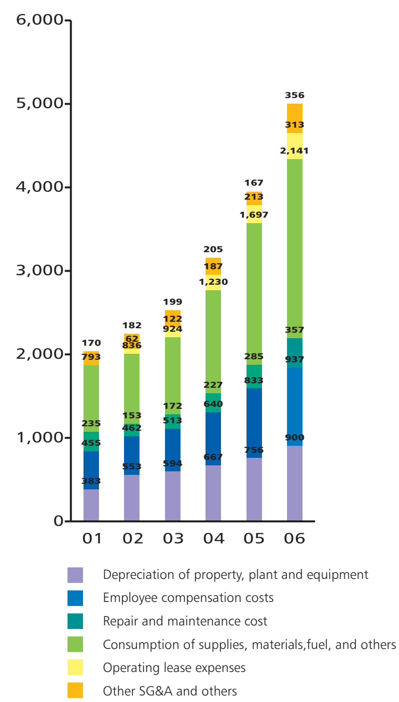
In 2006, operating expenses totaled RMB5,003.9 million, representing an increase of RMB1,052.5 million, or 26.6%, over RMB3,951.4 million in 2005. Of the increase, depreciation charges were RMB900.2 million, up by 19.1%. Labour costs amounted to RMB936.9 million, up by 12.4%. Repair and maintenance costs were RMB356.5 million, up by 25.0%. Costs relating to consumption of materials and other services amounted to RMB1,934.8 million, up by 34.6%. Sub-contracting costs were RMB206.3 million, down by 20.5%. Operating lease expenses amounted to RMB313.4 million, up by 46.9%. Other sales and management fees amounted to RMB81.2 million, up by 31.6%. Other operating expenses totaled RMB274.4 million, up by 160.6%.

Costs relating to consumption of materials and other services recorded a relatively greater increase, primarily due to increases in our operation volume resulting in more consumption of materials. Rise in the prices of raw materials also led to the increase. The increase of depreciation charges was mainly due to the commencement of operation of our new drilling rig COSL941, surveying vessel COSL709 and renovation of geophysical vessel COSL718. The rise in labour costs was mainly attributable to an increase in the number of equipment operators and staff members as a result of the use of new equipment and expansion into overseas markets. Operating lease expenses also recorded an increase, as the number of leasing days for drilling rigs, chemical tankers and seismic data collection standby vessel increased along with our business needs. Other operating expenses increased significantly, mainly because of the reversal of RMB59.7 million of provision for doubtful debt in 2005 and the increase in other operating expenses in additional overseas markets. Meanwhile, sub-contracting costs were reduced by the completion of the Nanbao construction project.

In 2006, operating expenses in our drilling services amounted to RMB2,262.9 million, representing an increase of RMB558.1 million, or 32.7%, from RMB1,704.8 million in 2005. Of the expenses, depreciation charges were RMB399.1 million, up by 23.4%. Labour costs amounted to RMB433.9 million, up by 19.4%. Repair and maintenance costs were RMB229.3 million, up by 23.9%. Costs relating to consumption of materials and other services amounted to RMB864.6 million, up by 49.9%. Sub-contracting costs were RMB5.6 million, down by 94.8%. Operating lease expenses amounted to RMB137.3 million, up by 30.3%. Other sales and management fees amounted to RMB41.2 million, up by 34.3%. Other operating expenses totaled RMB151.9 million, up by 1,097.5%.

Total Operating Expenses

RMB Million



MANAGEMENT DISCUSSION & ANALYSIS

Costs relating to consumption of materials and other services recorded an increase, because of a rise in operation volume of well repair and the increase in purchase prices for oil and materials. Depreciation charges were higher mainly as a result of the commencement of operation of the new drilling rig COSL941 and renovation of certain vessels. Operating lease expenses increased by 30.3%, attributable to the increase in the daily leasing rate and the leasing days following the completion of the renovation of leased jack-up rig COSL935. Other operating expenses recorded a relatively larger increase, mainly because of the write-off of RMB59.7 million of provision for doubtful debt in 2005. Meanwhile, sub-contracting costs were reduced due to the completion of the Nanbao construction project.

In 2006, operating expenses in our well services amounted to RMB1,182.3 million, representing an increase of RMB159.5 million, or 15.6%, from RMB1,022.8 million in 2005. Of the expenses, depreciation charges were RMB173.3 million, up by 39.1%. Labour costs amounted to RMB170.5 million, up by 2.2%. Repair and maintenance costs were RMB22.7 million, up by 20.9%. Costs relating to consumption of materials and other services amounted to RMB561.6 million, up by 14.0%. Sub-contracting costs were RMB136.5 million, down by 0.8%. Operating lease expenses amounted to RMB51.3 million, up by 50.8%. Other sales and management fees amounted to RMB15.9 million, up by 30.9%. Other operating expenses totaled RMB50.6 million, up by 40.2%.

Costs relating to consumption of materials and other services recorded an increase, primarily due to the increase in operation volume and the purchase prices for raw materials. The increase in depreciation charges was due to the acquisition of equipment for directional drilling, cementing and well completion. The increase in operating lease expenses was mainly attributable to increased leasing of equipment in line with the rise in our operation volume.

In 2006, operating expenses in marine support and transportation services amounted to RMB827.2 million, representing an increase of RMB69.8 million, or 9.2%, from RMB757.4 million in 2005. Of the expenses, depreciation charges were RMB210.7 million, down by 6.0%. Labour costs amounted to RMB215.1 million, up by 2.6%. Repair and maintenance costs were RMB65.3 million, up by 6.6%. Costs relating to consumption of materials and other services amounted to RMB211.3 million, up by 19.8%. Operating lease expenses amounted to RMB73.9 million, up by 73.7%. Other sales and management fees amounted to RMB12.7 million, up by 23.3%. Other operating expenses totaled RMB38.2 million, up by 15.1%.

Costs relating to consumption of materials and other services recorded an increase, mainly because of the rise in raw material prices and replacement of components. The increase in operating lease expenses is attributable to increased leasing of chemical tanker to meet demand for chemicals transportation. Depreciation charges decreased, as a result of the completion of the depreciation of some of the vessels.

In 2006, operating expenses in geophysical services amounted to RMB731.5 million, representing an increase of RMB265.1 million, or 56.8%, from the RMB466.4 million in 2005. Of the expenses, depreciation charges were RMB117.2 million, up by 40.2%. Labour costs amounted to RMB117.4 million, up by 25.7%. Repair and maintenance costs were RMB39.3 million, up by 94.8%. Costs relating to consumption of materials and other services amounted to RMB297.4 million, up by 55.5%. Sub-contracting costs were RMB64.2 million, up by 339.5%. Operating lease expenses amounted to RMB51.0 million, up by 61.6%. Other sales and management fees amounted to RMB11.4 million, up by 32.8%. Other operating expenses totaled RMB33.7 million, up by 44.6%.

MANAGEMENT DISCUSSION & ANALYSIS

2006 Profit from Operations

1,392.2

RMB Million

2006 Profit from Operations Increased

63.7%

from RMB 850.3 Million over 2005

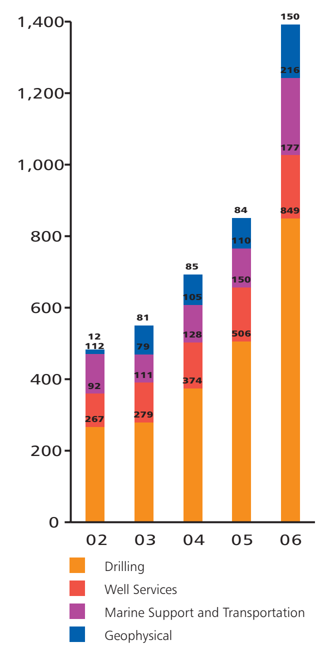
Costs relating to consumption of materials and other services recorded an increase, mainly because of the rise in prices of raw materials such as oil and the increase in the purchases of materials and transportation expenses in line with the increase in operation volume. Sub-contracting costs increased significantly with the increase in sub-contracting costs for surveying and groundwork. Depreciation charges became higher due to the renovation of 6-streamer rig COSL718 and 4-streamer Binhai 512. Operating lease expenses rose by 61.6%, primarily attributable to higher lease expenses for standby and positioning vessels as a result of the change in the mode of operations and increase in operation volume. The increase in repair and maintenance costs was mainly attributable to large-scale maintenance of vessels including BH512 and BH511 according to needs.

Operating Profit

In 2006, we achieved an operating profit of RMB1,392.2 million, representing an increase of RMB541.9 million, or 63.7%, compared to the RMB850.3 million in 2005. The increase in operating profit was mainly due to the relatively larger growth in drilling, offshore utility vessel and transportation services businesses. Of the profit, drilling services recorded an operating profit of RMB849.3 million, representing an increase of RMB343.8, or 68.0%, from the RMB505.5 million in 2005. Well services recorded an operating profit of RMB176.9 million, representing an increase of RMB26.5 million, or 17.6%, from the RMB150.4 million in 2005. Marine support and transportation services recorded an operating profit of RMB215.6 million, representing an increase of RMB105.3 million, or 95.5%, from the RMB110.3 million in 2005. Geophysical services recorded an operating profit of RMB150.4 million, representing an increase of RMB66.3 million, or 78.8%, from the RMB84.1 million in 2005.

Operating Profit

RMB Million



Financial Expenses

Financial expenses in 2006 amounted to RMB55.5 million, compared to the financial income of RMB0.05 million in 2005. The increase in financial expenses of RMB55.6 million consisted of the increase in the loss from currency exchange of RMB29.9 million, the increase in interest expenses of RMB36.6 million and the increase in interest income of RMB10.9 million.

MANAGEMENT DISCUSSION & ANALYSIS

Share of Profits from Jointly-Controlled Entities

Our share of profits from jointly-controlled entities amounted to RMB113.5 million in 2006, representing an increase of RMB6.9 million, or 6.5%, compared to RMB106.6 million in 2005. The increase was mainly attributable to the increase in profits from China Nanhai-Magcobar Mud, China-France Bohai Geoservices and China Petroleum Logging-Atlas Cooperation Service Company compared to those in 2005.

Profit Before Tax

Profit before tax amounted to RMB1,450.2 million in 2006, representing an increase of RMB493.3 million, or 51.6%, compared to RMB956.9 million in 2005. The increase was mainly attributable to the increase in our drilling services and marine support and transportation services.

Income Tax

In 2006, we had a net income tax expense of RMB322.0 million, representing an increase of RMB186.1 million, or 136.9%, compared to RMB135.9 million in 2005. We recorded tax liabilities in 2006 of RMB498.0 million, offset by a tax refund of RMB176.0 million from the tax authority attributable to the reduction in our corporate income tax rate from 33% to 15% in 2005 as a result of the approval of our status as an advanced technology enterprise in 2005.

Profit After Tax

Our profit after tax in 2006 was RMB1,128.2 million, representing an increase of RMB307.2 million, or 37.4%, compared to RMB821.0 million in 2005.

2006 Tax

332

RMB Million

2006 Net Profit

1,128

RMB Million

2006 Net Profit Increased

37.4%

from RMB 821.0 Million over 2005

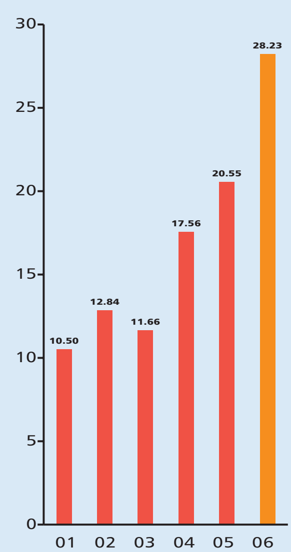
2006 EPS

28.23

RMB Cents

COSL EPS

RMB Cents



MANAGEMENT DISCUSSION & ANALYSIS

Dividends

We did not declare or pay any special interim dividend in 2006. Our Board proposed to declare a year-end final dividend of RMB239.7 million or RMB0.06 per share. The recommended date for distribution is 20 June 2007 (Wednesday).

Debt Servicing Ability and Funding Resources

Cash and cash equivalents amounted to RMB1,013.8 million at the opening of the year 2006. For this twelve-month period, net cash inflow from operating activities was RMB1,818.7 million, net cash outflow from investing activities was RMB1,758.3 million, net cash inflow from financing activities was RMB1,400.8 million and time deposits for more than three months decreased by RMB165.5 million. As at 31 December 2006, we had cash and cash equivalents amounting to RMB2,309.5 million.

Cash Generated from Operations

Net cash generated from operating activities amounted to RMB1,818.7 million in 2006, representing an increase of RMB557.3 million, or 44.2%, compared to RMB1,261.4 million in 2005. The increase mainly comprised a RMB542.0 million increase in operating profit, a RMB144.6 million increase in depreciation charges, an increase in salary and bonus payable of RMB52.2 million, an increase in provision for doubtful debts and inventory of RMB61.0 million, an increase in prepayment, deposit and other account receivables of RMB213.3 million, offset by a decrease in trade and other payable of RMB30.7 million; an increase in tax liabilities of RMB93.0 million, accounts receivable decreased by RMB292.9 million, loss of foreign exchange decreased by RMB29.9 million and other cash provided by operation decreased by RMB9.3 million.

Capital Expenditure

To meet domestic and international demand for oilfield services, we continued to increase our capital expenditure and enhance our operating capacity. Capital expenditure in 2006 was RMB2,715.2 million, representing an increase of RMB462.2 million, or 20.5%, from the RMB2,253.0 million in 2005. Capital expenditure for drilling services was RMB1,201.6 million, which was mainly spent on the construction of two 400-feet jack-up rigs, two liftboats and four module rigs for our business in Mexico. Capital expenditure for well services was RMB522.7 million, which was mainly used on the purchase of equipment for cementing and logging. Capital expenditure for marine support and transportation services was RMB846.7 million, which was mainly spent on the construction of 18 marine support vessels, the purchase of 2 second-hand utility vessels, the purchase of 2 chemical carriers, the construction of 2 chemical carriers and the establishment of the joint venture, Eastern Marine Services Ltd., with Trico Marine Services Inc. Capital expenditure for geophysical services was RMB144.2 million, which was primarily spent on the renovation of the 6-streamer dual-source COSL718 and the modification of 1 PSV vessel into an 8-streamer geophysical vessel.

Cash Inflow from Financing Activities

In 2006, net cash inflow from financing activities amounted to RMB1,400.8 million, comprising the issue of RMB965.0 million short-term bond, a new long-term bank loan of RMB600.0 million, partially offset by dividend payment of RMB164.2 million.

MANAGEMENT DISCUSSION & ANALYSIS

Subsequent Events

In accordance with our Articles of Association, an Extraordinary General Meeting of the shareholders was convened on 31 January 2007 for the approval of the special resolution in relation to the issue of long term bonds with an aggregate principal amount not exceeding RMB 2 billion. The long term bonds will be issued to institutional investors in the PRC. The long term bonds are unsecured, with a term of 10 to 20 years. It is expected that the proceeds from the bonds issue will be used by us to build upgrade drilling rigs, purchase and construction of chemical and working vessels, upgrade seismic vessels and build lifeboats and for our general working capital.

The short term debenture of total face value of RMB1 billion were repaid in full by us in February 2007.

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ("the New Corporate Income Tax Law") was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group cannot be reasonably estimated at this stage.

Outlook

We expect the global economy to continue its steady growth in 2007, whilst the economic growth in India, China, Brazil and Russia will remain robust. According to the forecast of the International Monetary Fund, global economy will grow by 4.9% in 2007, 0.2 percentage point lower than that in 2006. With the backdrop of economic growth, demand for crude oil will experience a slight increase. The monthly report in December 2006 by the International Energy Agency estimated the daily global demand for crude oil in 2007 to be 85.9 million barrels, a growth of 1.7% compared to 2006. OPEC still plays a major part in the global supply market of oil, with an ever increasing supply of oil from non-OPEC countries and regions, such as Russia, Central Asia, Africa, the Middle East, the Far East, Brazil and Mexico. There will still be tension between the supply and demand for crude oil in the long run.

Global investment in oil exploration and production may continus to witness some growth in 2007 after an active year in 2006, albeit at a slower pace. Whereas investment in exploration and production in North America is estimated to drop, investment in South East Asia, Russia and Africa will increase. Lehman Brothers estimates that global investment in exploration and production will reach US$291 billion in 2007, representing an increase of 9% compared to 2006. Focus of exploration investment will extend further to cover regions other than North America, and will spread to offshore exploration, deep ocean exploration in particular. According to the 2007 strategy announced by CNOOC Limited, its capital expenditure in 2007 will reach US$4.18 billion, which will be used for 5 investment items, over 10 projects under construction, planned 2D seismic data collection of over 24,000 kilometers and 3D seismic data colletion of 4,900 sq. kilometers. The oilfield services market will display a promising developmental trend.

In the year to come, we will maintain our leading position in the China offshore oilfield services market, and at the same time will further strengthen our presence in the South East Asia markets, expand further into the regional markets of Mexico, Africa, the Middle East and Russia, in order to generate profits from both domestic and overseas

MANAGEMENT DISCUSSION & ANALYSIS

markets. The contract for the construction and operation of 4 drilling platforms for PEMEX in Mexico that we already secured, cementing contract in Papua New Guinea and other contracts will facilitate growth in our revenue from overseas business. Meanwhile, we intend to further expand through acquisitions and joint ventures. To facilitate our long-term development, we expect to invest RMB3.2 billion on capital expenditure in 2007, which is 18% more than the RMB2.7 billion in 2006. Capital expenditure in 2008-2009 is currently estimated to maintain at the same level. The funds that we require will not only come from our daily operations and production and we plan to make use of various financing tools, including issue of A shares in the PRC domestic market, issue of long-term bonds, and borrowing of project loans if their terms are favorable. We will continue to follow a prudent financial policy to further improve our capital structure and minimize cost of funds.

Looking ahead, we will continue to commit to our corporate philosophy of "We Must Do Better" and implement our four core strategies of technological advancement, cost leadership, integrated project management and internationalization. We will grasp the opportunities to maximize our scale of economy, enhance market oriented operations, accelerate technological progress, manage our construction projects and continue to put safety and environmental protection as our priority. We believe that we can continue our trend of growth since our listing, and will realize an all-win situation with our shareholders, clients, employees and business partners.