

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 2006.

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, leasing of geophysical vessels, provision of drilling fluids services 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 2006 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 65 to 70.

The directors recommend the payment of a final dividend of RMB0.06 per ordinary share in respect of the year to shareholders whose names appear on the register of members on 7 May 2007. This recommendation has been incorporated in the financial statements as an allocation of retained profit within the equity section of the balance sheet. This dividend amounts to about RMB239.7 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 2006 are set out in note 16 to the financial statements.

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Summary Financial information

A summary of the published results and the assets, liabilities and minority interests of the Group for the last five years as extracted from the audited financial statements and reclassified as appropriate set out as blow. This summary does not form part of the audited financial statements.

Results	2006 RMB'000	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000 (note)
Turnover	6,364,839	4,788,792	3,824,029	3,062,255	2,725,782
Other revenues	31,341	12,919	23,488	11,720	4,600
Operating expenses					
Depreciation of property, plant and equipment	(900,244)	(755,676)	(666,971)	(594,003)	(552,523)
Employee compensation costs	(936,936)	(833,345)	(640,153)	(513,098)	(462,293)
Repair and maintenance costs	(356,510)	(285,166)	(226,733)	(172,139)	(152,693)
Consumption of supplies, materials, fuel, services, subcontracting expenses and others	(2,141,142)	(1,696,796)	(1,230,070)	(924,412)	(836,460)
Operating lease expenses	(313,431)	(213,436)	(186,828)	(121,526)	(61,522)
Other operating expenses	(274,444)	(105,288)	(166,549)	(165,533)	(139,394)
Other selling, general and administrative expenses	(81,231)	(61,737)	(38,045)	(33,489)	(42,475)
Total operating expenses	(5,003,938)	(3,951,444)	(3,155,349)	(2,524,200)	(2,247,360)
Profit from operations	1,392,242	850,267	692,168	549,775	483,022
Financial income					
Exchange losses, net	(46,694)	(16,802)	199	(716)	(973)
Finance costs	(36,708)	(104)	-	-	(5,289)
Interest income	27,856	16,956	34,300	32,175	11,216
Total financial expenses/income	(55,546)	50	34,499	31,459	4,954
Share of profits of jointly-controlled entities	113,505	106,617	79,445	38,663	28,384
Profit before tax	1,450,201	956,934	806,112	619,897	516,360
Tax	(321,966)	(135,938)	(104,385)	(153,991)	(161,974)
Profit for the year	1,128,235	820,996	701,727	465,906	354,386

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Summary Financial information continued

Assets and liabilities

	2006 RMB'000	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000 (note)
Total assets	13,130,170	9,709,875	9,140,820	8,231,055	7,957,532
Total liabilities	(4,511,626)	(2,055,133)	(2,076,144)	(1,685,919)	(1,776,937)
	8,618,544	7,654,742	7,064,676	6,545,136	6,180,595

Note:

- 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 15 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 or 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 its subsidiaries purchased, redeemed or sold any of its listed securities during this year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 30 to the financial statements and in the consolidated statement of changes in equity, respectively.

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Distributable reserves

As at 31 December 2006, 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 RMB443 million standing to the credit of the Company's statutory reserve funds (details of which are set forth in note 30 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 out in note 30 to the financial statements, the Company had retained profits of approximately RMB2,015 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 2006.

Charitable contributions

During the year, the Group made charitable donations totaling RMB216,000.

Major customers and suppliers

In the year under review, sales to the Group's five largest customers accounted for 83.9% of the total sales for the year and sales to the largest customer included therein accounted for approximately 63.7%. Purchases from the Group's five largest suppliers accounted for approximately 33% 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 section '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

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 directors and supervisors of the Company during the year were:

Executive directors:

Yuan Guangyu

Li Yong (appointed on 25 May 2006)

Non-executive director:

Fu Chengyu

Wu Mengfei

Independent non-executive directors:

Gordon C.K. Kwong

Andrew Y. Yan

Simon X. Jiang

Independent Supervisors:

Zhang Dunjie

Supervisors:

Zhang Benchun

Xiao Jianmin

Tang Daizhi

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

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Directors, supervisors and senior biographies

Biographical details of the directors and supervisors of the Company and the senior management of the Group are set out on pages 49 to 52 of the Annual Report.

Directors and supervisors service contracts

Each of the independent non-executive directors and independent supervisor 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 2006 are set out in note 8 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 the duties and responsibilities of the directors, the remuneration committee's recommendation and performance and the 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 holding company 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 34 to the financial statements.

Save as disclosed, no contract 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 2006, 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 which would fall to be notified to the Company, pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance (the "SFO") or Section 352 of 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.

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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 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.

Substantial shareholders' and other persons' interests in shares

As at 31 December 2006, so far as is known to any director, or the chief executive, the following person (not being a director, supervisor or chief executive of the Company) had interests or short positions in the shares which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV 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%	61.58%
Fidelity International Limited	Interest in a controlled corporation	140,264,000(L) H shares	9.14%	3.51%
Commonwealth Bank of Australia	Interest in a controlled corporation (note b)	79,096,000(L) H shares	5.15%	1.98%
SKAGEN Kon-Tiki Verdipapirfond	Interest in a controlled corporation (note c)	78,236,000(P) H shares	5.10%	1.96%

Notes:

- (a) "L" denotes long position.
- (b) The direct beneficial owner is First State Investment Managers (Asia) Ltd, and First State Investment Managers (Asia) Ltd is wholly owned by Commonwealth Bank of Australia.
- (c) The direct beneficial owner is Stavanger Fondsforvaltning AS, and Stavanger Fondsforvaltning AS is wholly owned by SKAGEN Kon-Tiki Verdipapirfond.

Save as disclosed above, the directors are not aware of any other person who had an interest in the shares of the Company which would fall to be disclosed to the Company 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 Stock Exchange of Hong Kong Limited ("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 2006, the Group had the following connected transactions:

	2006 RMB'000
A. Gross revenue earned from provision of services to the following parties:	
a. CNOOC Limited Group	
Provision of drilling services	1,786,019
Provision of well services	1,121,702
Provision of marine support and transportation services	699,921
Provision of geophysical services	531,059
	4,138,701
b. CNOOC Group (including services provided by China Nanhai-Magcobar Mud Corporation Ltd. ("Magcobar"))	
Provision of drilling services	9,624
Provision of well services	526
Provision of marine support and transportation services	147,083
Provision of geophysical services	63,887
	221,120
c. Jointly-controlled entities	
Provision of drilling services	204
Provision of well services	4,745
Provision of marine support and transportation services	54
	5,003
B. Included in operating expenses (including services provided to Magcobar)	
Services provided by the CNOOC Group:	
Labour services	10,550
Materials, utilities and other ancillary services	197,656
Transportation services	5,244
Lease of office, warehouse, and berths	47,651
Repair and maintenance services	12,842
Management services	15,449
	289,392

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Connected transactions (continued)

	2006 RMB'000
C. Deposits placed with CNOOC Finance Company at 31 December 2006	104
D. Interest income earned from deposits placed with CNOOC Finance Company	1

For items (A) and (B) above, the independent shareholders of the Company granted approval for the Company to enter into the connected transactions set out by ordinary resolutions at the extraordinary general meeting held on 29 November 2004. For items (C) and (D), these transactions were qualified as "De minimum transaction" as defined in the Listing Rules.

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 to the best 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 36 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 2006 annual results with the management.

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Code on Corporate Governance Practices

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 36 to 41 of this annual report. The Company is committed to the establishment of good corporate governance practices and procedures including the application of the principles of a quality board, sound internal control, transparency and accountability to its Shareholders. Pursuant to Code Provision E.1.2 of the Code on Corporate Governance Practices as stated in Appendix 14 to the Listing Rules, the Chairman of the Board should, among other things, attend the annual general meeting of the Company. Mr. Fu Chengyu, the Chairman of the Company, failed to attend the annual general meeting of the Company held on 25 May 2006 due to an unexpected matter that required his immediate attention. Mr. Simon X. Jiang was elected the chairman of the meeting in accordance with the Articles of Association of the Company. Save as disclosed, the Company has complied strictly with the Code on Corporate Governance Practices as stated in Appendix 14 of the Listing Rules throughout the 12 months ended 31 December 2006.

Model Code for Securities Transactions by Directors of Listed Issuers

Upon specific enquiry to each and every director by the Company, the Board of Directors confirms that all the members 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

Ernst & Young 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
23 March 2007