

Report of the Directors

The directors submit their report together with the audited accounts for the year ended 31st December 2002.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities of its principal subsidiaries are the exploration and production of crude oil and natural gas in the People's Republic of China ("PRC"), South America, Central Asia and South East Asia.

An analysis of the Group's performance for the year by geographical and business segments is set out in note 3 to the accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated profit and loss account on page 27.

The directors recommend the payment of a final dividend of HK\$0.035 per share for the year ended 31st December 2002, totalling HK\$170,842,000.

RESERVES

Movements in the reserves of the Group and the Company during the year are set out in note 25 to the accounts.

DONATIONS

Charitable and other donations made by the Group during the year amounted to HK\$10,000 (2001: HK\$10,000).

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and the Company during the year are set out in note 12 to the accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 24 to the accounts.

FIVE YEAR FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 78.

PURCHASE, SALE OR REDEMPTION OF SHARES

During the year, 48,820,000 shares of HK\$0.01 each of the Company were repurchased by the Company through The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), details of which are as follows:

Month	Number of shares repurchased	Price per share		Aggregate amount paid HK\$'000
		Highest price HK\$	Lowest price HK\$	
July	13,670,000	0.58	0.52	7,475
August	17,190,000	0.58	0.54	9,548
September	6,600,000	0.55	0.52	3,498
October	11,360,000	0.55	0.53	6,147
	<u>48,820,000</u>			<u>26,668</u>

All of the shares repurchased were cancelled.

Save for the foregoing, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares during the year.

DIRECTORS

The directors during the year and up to the date of this report were:

Mr Wang Mingcai

Mr Li Hualin

Mr Lin Jingao

Dr Lau Wah Sum

Mr Aubrey Li Kwok Sing

Mr Xu Tianshu

(resigned on 3rd January 2003)

DIRECTORS (continued)

In accordance with Article 97 of the Company's Bye-Laws, Dr Lau Wah Sum shall retire by rotation at the forthcoming Annual General Meeting and, being eligible, offer himself for re-election.

None of the directors has a service contract with the Company which is not determinable by the Company within one year without payment of compensation.

Dr Lau Wah Sum, Independent Non-Executive Director, was appointed for a two-year term expired on 31st December 2002. The appointment was further extended for another two years to 31st December 2004.

Mr Aubrey Li Kwok Sing, Independent Non-Executive Director, was appointed for a two-year term expired on 31st July 2002. The appointment was further extended for another two years to 31st July 2004.

The terms of office of the Independent Non-Executive Directors are subject to retirement as required by the Company's Bye-Laws.

BRIEF BIOGRAPHICAL DETAILS IN RESPECT OF DIRECTORS AND SENIOR MANAGEMENT

Directors

Mr Wang Mingcai (*Executive Chairman*)

Age 57, graduated from Petroleum University of Beijing in 1970 with Bachelor's Degree in Petroleum Geology and was awarded the Certificate of Mastery in English from Zhongshan University in 1987. Mr Wang has more than 30 years' experience in the petroleum industry. He has worked at Liaohe Oil Field as Engineer and Project Manager; Senior Engineer and Project Manager of China Offshore Oil Nanhai East Corp and Senior Oil Reservoir Engineer of the ACT (with Agip, Chevron and Texaco) Operation group. From 1993, Mr Wang has been assigned to be responsible for China National Petroleum Corporation ("CNPC") overseas projects. He was the President of CNPC International Venezuela Ltd. Mr Wang joined the Company as Executive Chairman in January 2001.

BRIEF BIOGRAPHICAL DETAILS IN RESPECT OF DIRECTORS AND SENIOR MANAGEMENT (continued)

Directors (continued)

Mr Li Hualin *(Executive Vice-Chairman & Managing Director)*

Age 40, after graduated from South West Petroleum University in 1983 with Bachelor's Degree in Oil and Gas Exploration and Prospecting Engineering, Mr Li joined CNPC in the same year. He was the Deputy Director of CNPC office at Houston in the U.S.A.; Chairman & General Manager of CNPC Canada Ltd in Canada and Deputy General Manager of China National Oil and Gas Exploration and Development Corporation. In 2000, Mr Li was awarded the degree of Master of Business Administration from The University of Nebraska. Mr Li joined the Company as Executive Vice-Chairman & Managing Director in January 2001.

Mr Xu Tianshu *(Executive Director)*

Age 36, graduated from China Petroleum University with Bachelor and Master Degree of Science in Management Engineering. Mr Xu joined CNPC in 1990. He worked at the former Shanghai Petroleum Exchange and Beijing Petroleum Exchange as Director of a division and Deputy Director of Petroleum Economy Division of CNPC Economy and Information Research Centre. He joined the Company in July 1998 and was appointed as Executive Director in December 1998. He resigned from the Company in January 2003.

Mr Lin Jingao *(Non-Executive Director)*

Age 58, graduated from the Beijing College of Petroleum, Department of Economics in 1967. Mr Lin has more than 30 years' experience in petroleum economics and financial management. He has worked at Sichuan Petroleum Administration Bureau as Deputy Chief of Economic Research. Since August 1994, Mr Lin worked as the Chief Financial Controller and Deputy Director of CNPC's Finance Department. In 1997, he joined the Company and CNPC Hong Kong (Holdings) Limited as Non-Executive Director.

BRIEF BIOGRAPHICAL DETAILS IN RESPECT OF DIRECTORS AND SENIOR MANAGEMENT (continued)

Directors (continued)

Dr Lau Wah Sum, GBS, LLD, DBA, JP (*Independent Non-Executive Director*)

Age 75, is a Fellow of the Chartered Institute of Management Accountants. He is currently the President of W S Lau & Associates Limited and Chairman of Equity Holdings Limited. He serves the community as Chairman of Urban Renewal Authority, Court Member of the University of Science and Technology of Hong Kong. He also sits on the Board of several listed companies in Hong Kong. He joined the Company as an Independent Non-Executive Director in August 1994.

Mr Aubrey Li Kwok Sing (*Independent Non-Executive Director*)

Age 53, was appointed as an Independent Non-Executive Director of the Company in 1998. He is a director of Management Capital Limited, a financial advisory and direct investment firm, and has over 25 years' experience in merchant banking and commercial banking. He is also a non-executive director of The Bank of East Asia, Limited, Cafe de Coral Holdings Limited, China Everbright International Limited, Chinney Alliance Group Limited, Kowloon Development Company Limited and Value Partners China Greenchip Fund Limited. He is a non-executive chairman of Atlantis Asian Recovery Fund plc. Mr Li has a Master of Business Administration from Columbia University and a Bachelor of Science in Civil Engineering from Brown University.

Senior Management

Mr Lau Hak Woon (*General Manager – Finance and Company Secretary*)

Age 50, member of Hong Kong Society of Accountants in Hong Kong; fellow member of The Chartered Association of Certified Accountants in UK and Certified Management Accountant of the Society of Management Accountants of Ontario in Canada. Mr Lau has a Master of Business Administration from Newport University and more than 25 years' experience in accounting and financial management. He joined the Company in 1997. Before joining the Company, he was the Chief Financial Officer of several large companies in Hong Kong and Canada.

DIRECTORS' INTERESTS IN CONTRACTS

On 15th January 1997, the Company entered into a consultancy agreement with W S Lau & Associates Limited of which Dr Lau Wah Sum is a shareholder and director. Pursuant to the agreement, W S Lau & Associates Limited provides general consultancy services to the Company with effect from 1st January 1997 in return for a consultancy fee of HK\$350,000 per annum. The agreement shall continue until terminated by either party by six months' written notice.

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

DIRECTORS' INTERESTS IN SHARES

At 31st December 2002, the interests of the directors and senior executive in the shares of the Company as recorded in the register maintained under section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") or as notified to the Company were as follows:

- (a) Messrs Wang Mingcai and Li Hualin are directors of Sun World Limited ("Sun World") which beneficially owned 2,862,937,342 shares in the Company as at 31st December 2002. Sun World is a wholly owned subsidiary of CNPC, the Company's ultimate holding company incorporated in the PRC.
- (b) Share options are granted to directors and senior executive under various share option schemes approved by the board of directors on 23rd October 1991, 28th May 2001 and 3rd June 2002. Details are set out in the section headed "Share Options" of this report.

Save for the above, at no time during the year was the Company, its subsidiaries or its holding company a party to any arrangements to enable the directors or senior executive or any of their spouses or children under 18 years of age to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

SHARE OPTIONS

Pursuant to a resolution passed on 23rd October 1991, an executive share option scheme (the “1991 Share Option Scheme”) was adopted by the Company. The directors of the Company may, at their discretion, invite executives of any companies within the Group, including executive directors, to take up options to subscribe for shares in the Company subject to the terms and conditions stipulated in the 1991 Share Option Scheme. The 1991 Share Option Scheme was early terminated on 28th May 2001 with the share options granted under such scheme still valid until their respective expiry dates. On the same date, another share option scheme (the “2001 Share Option Scheme”) was adopted.

On 3rd June 2002, the shareholders of the Company approved the termination (to the effect that no further options shall be offered) of the 2001 Share Option Scheme and the adoption of a new share option scheme (the “2002 Share Option Scheme”). As at 31st December 2002, options to subscribe for a total of 140,000,000 option shares were still outstanding under the 1991 Share Option Scheme. No option has been granted under the 2001 Share Option Scheme and 2002 Share Option Scheme.

The following is a summary of the principal terms of share option schemes of the Company (for the 1991 and 2001 Share Option Scheme, only those terms applying to the outstanding option shares are set out below):

(a) 1991 and 2001 Share Option Schemes

The 1991 and 2001 Share Option Schemes were designed to give executive directors and full-time employee of the Group equity interest in the Company in order to enhance long-term shareholder value. The granting of options will also help the Company to attract and motivate individuals with experience and ability and to reward individuals for past and future performance.

Options may be exercised at any time, but not less than 3 months and not more than 10 years from the date on which the option is granted and accepted by grantee. No amount shall be payable by the grantee to the Company in exercising the right to accept an offer of an option.

The total number of shares available for issue under the 1991 Share Option Scheme as at the date of the annual report is 140,000,000, representing approximately 3% of the issued share capital of the Company as of that date. The maximum entitlement of any qualifying participant shall not exceed 25% of the aggregate number of shares subject to the schemes.

The 1991 Share Option Scheme and 2001 Share Option Scheme were terminated on 28th May 2001 and 3rd June 2002 respectively such that thereafter no further options will be granted and the existing options shall continue to be valid and exercisable in accordance with their terms of issue.

SHARE OPTIONS (continued)

(b) 2002 Share Option Scheme

The purpose of the 2002 Share Option Scheme is to provide incentives to the directors and full-time employees of the Company to contribute to the Company and to enable the Company to recruit high-calibre employees and attract human resources that are valuable to the Company.

The maximum number of shares which may be issued upon exercise of all options to be granted under the 2002 Share Option Scheme shall not in aggregate exceed 10% of the shares in issue as at the date of adoption of the 2002 Share Option Scheme (the “Scheme Mandate Limit”), provided that the Company may, at any time as the board of directors of the Company may think fit, seek approval from its shareholders to refresh the Scheme Mandate Limit in accordance with the provisions of the Listing Rules. Notwithstanding aforesaid in this paragraph, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the 2002 Share Option Scheme (and under any other scheme of the Company) shall not exceed 30% of the shares in issue from time to time.

Options may be exercised at any time, but not less than 3 months and not more than 10 years from the date on which the option is granted and accepted by grantee. No amount shall be payable by the grantee to the Company in exercising the right to accept an offer of an option.

The exercise price shall be fixed at such level as the board of directors may determine save that it shall be at least the highest of (i) the closing price of the shares as stated in the Stock Exchange’s daily quotations sheets on the date of grant, which must be a business day; (ii) the average closing price of the shares as stated in the Stock Exchange’s daily quotations sheets for the five business days immediately preceding the date of grant, and (iii) the par value of the shares for the time being.

The 2002 Share Option Scheme will expire on 2nd June 2012.

SHARE OPTIONS (continued)

(b) 2002 Share Option Scheme (continued)

The following shows the particulars of share options granted to directors and senior executive of the Company that are required to be disclosed under Rule 17.07 of the Rules Governing the Listing of Securities on the Stock Exchange (the “Listing Rules”):

Name	Date of grant	Exercise price HK\$	Number of options			Exercisable period
			Balance at 1st January 2002	Lapsed during the year	Balance at 31st December 2002	
Mr Wang Mingcai	8th March 2001	0.41	20,000,000	–	20,000,000	8th June 2001 to 7th March 2006
	26th April 2001	0.61	30,000,000	–	30,000,000	26th July 2001 to 25th April 2006
Mr Li Hualin	8th March 2001	0.41	20,000,000	–	20,000,000	8th June 2001 to 7th March 2006
	26th April 2001	0.61	20,000,000	–	20,000,000	26th July 2001 to 25th April 2006
Mr Lin Jingao	16th June 1997	1.31	20,000,000	20,000,000	–	16th September 1997 to 15th June 2002
	26th April 2001	0.61	10,000,000	–	10,000,000	26th July 2001 to 25th April 2006
Mr Xu Tianshu (Resigned on 3rd January 2003, note 1)	12th May 1999	0.91	20,000,000	–	20,000,000	12th August 1999 to 11th May 2004
	26th April 2001	0.61	10,000,000	–	10,000,000	26th July 2001 to 25th April 2006

SHARE OPTIONS (continued)

(b) 2002 Share Option Scheme (continued)

Name	Date of grant	Exercise price HK\$	Number of options			Exercisable period
			Balance at 1st January 2002	Lapsed during the year	Balance at 31st December 2002	
Mr Zhang Ruchun (Retired on 18th January 2001)	16th June 1997	1.31	20,000,000	20,000,000	—	16th September 1997 to 15th June 2002
Mr Lau Hak Woon	16th June 1997	1.39	5,000,000	5,000,000	—	16th September 1997 to 15th June 2002
	3rd March 1998	1.61	5,000,000	—	5,000,000	3rd June 1998 to 3rd March 2003
	26th April 2001	0.61	5,000,000	—	5,000,000	26th July 2001 to 25th April 2006
			<u>185,000,000</u>	<u>45,000,000</u>	<u>140,000,000</u>	

Notes:

1. Mr Xu Tianshu resigned as a director of the Company on 3rd January 2003 and pursuant to the 1991 Share Option Scheme his share options were cancelled on 3rd January 2003.
2. No share option was granted, exercised or cancelled during the year.

SUBSTANTIAL SHAREHOLDERS

At 31st December 2002, the register of substantial shareholders maintained under section 16(1) of the SDI Ordinance showed that the Company has been notified of the following interests being 10% or more of the Company's issued share capital:

Name of shareholder	Number of shares held
Sun World	2,862,937,342*

* 2,513,472,468 shares are registered under the name of HKSCC Nominees Limited.

Sun World is a wholly owned subsidiary of CNPC and CNPC is accordingly deemed to have interest in the 2,862,937,342 shares held by Sun World.

PRE-EMPTIVE RIGHTS

No pre-emptive rights exist under Bermuda Law in relation to issues of new shares of the Company.

CONNECTED TRANSACTIONS

Pursuant to Chapter 14 of the Listing Rules, the following connected transactions of the Company require disclosure in the annual report of the Company.

- (a) On 7th February 2002, an additional amount of RMB40,000,000 (approximately HK\$38,000,000) in cash was contributed to the registered capital of 華油鋼管有限公司("North China"), an entity jointly controlled by the Company and 華北石油管理局 (the "Bureau"), to finance the purchase of assets and liabilities relating to a steel pipe production line of a factory wholly owned by the Bureau. The Bureau is an operational entity owned and operated by CNPC and is therefore a connected person of the Company under the Listing Rules.

On 24th December 2002, a further amount of RMB40,000,000 (approximately HK\$38,000,000) in cash was contributed to the registered capital of North China to finance the setting up of a branch factory to manufacture mid-sized welded steel pipes in the Pudong Economic Development Zone, Shanghai, the PRC. North China is an associate of CNPC and is therefore a connected person of the Company under the Listing Rules.

CONNECTED TRANSACTIONS (continued)

- (b) On 16th December 2002, the Company entered into an equity transfer contract with Daqing De Venezuela C.A. (“De Venezuela”) to acquire 25% equity interest in the registered share capital of 青島慶昕塑料有限公司 (“the Qingdao JV”), a joint venture company formed by De Venezuela and 中國大慶石油管理局 (“Daqing Bureau”). No consideration was payable for the acquisition but the Company has to assume the responsibilities of a shareholder of the Qingdao JV and contribute US\$3,750,000 (approximately HK\$29,250,000) to the registered capital of the Qingdao JV. The Qingdao JV will engage in the production of certain petro-chemical products including biaxially oriented polypropylene film. The Daqing Bureau is an operational entity owned and operated by CNPC and is therefore a connected person of the Company under the Listing Rules.

In addition to the above, the Group entered into certain transactions with related parties as set out in note 28 to the accounts which also constitute connected transactions under Chapter 14 of the Listing Rules. The independent non-executive directors, Dr Lau Wah Sum and Mr Aubrey Li Kwok Sing, have reviewed the transactions disclosed in note 28 to the accounts and confirmed that these transactions are in the ordinary and usual course of business, on normal commercial terms and are fair and reasonable so far as the interests of shareholders of the Company are concerned.

MANAGEMENT CONTRACTS

Save for the Entrustment Contracts as mentioned in notes 31 and 32 to the accounts in relation to the management of the crude oil production under the Xinjiang Contract and the Leng Jiapu Contract, no other contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existing during the year.

MAJOR CUSTOMERS AND SUPPLIERS

The percentage of the Group’s purchases and sales attributable to major suppliers and customers are as follows:

Percentage of purchases attributable to the Group’s largest supplier	27%
Percentage of purchases attributable to the Group’s five largest suppliers	40%
Percentage of sales attributable to the Group’s largest customer	57%
Percentage of sales attributable to the Group’s five largest customers	94%

Liaohe Petroleum Exploration Bureau (“LPEB”) is the Group’s largest supplier.

PetroChina Company Limited, a listed subsidiary of CNPC, is the Group’s largest customer.

LPEB is an operational entity owned and controlled by CNPC.

Save for the above, none of the directors, their associates or any shareholders which to the knowledge of the directors owns more than 5% of the Company’s share capital has an interest in the major suppliers or customers noted above.

CORPORATE GOVERNANCE

During the year, the Company was in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules.

AUDIT COMMITTEE

Pursuant to the Listing Rules, an audit committee, comprising two independent non-executive directors, namely Dr Lau Wah Sum and Mr Aubrey Li Kwok Sing, was established on 8th December 1998.

By reference to “A Guide for The Formation of An Audit Committee” published by the Hong Kong Society of Accountants, written terms of reference which describe the authority and duties of the audit committee were prepared and adopted by the board of the directors of the Company on the same date. The principal activities of the audit committee include the review and supervision of the Group’s financial reporting process and internal controls.

SUBSEQUENT EVENTS

On 24th January 2003, Smart Achieve Developments Limited, a wholly owned subsidiary of the Company, entered into a Sale and Purchase Agreement with Rosco S.A. (“RSA”) to acquire:

- (a) 31.41% of the issued share capital of Commonwealth Gobustan Limited (“CGL”) (“the Sale Shares”) who has an undivided 80% participating interest in the right to explore, develop and produce crude oil in the Three Blocks of the South-West Gobustan in the Azerbaijan Republic; and
- (b) 30% of all the outstanding loans advanced by RSA to CGL under the Loan Agreement dated 26th March 2002 (“the Loan”).

The consideration for the acquisition of the Sale Shares and the Loan are US\$10,500,000 (approximately HK\$81,900,000) and 30% of the aggregate amount (plus interest thereon) advanced to CGL by RSA respectively.

On the same date, CNPC International Ltd, a wholly owned subsidiary of CNPC, entered into a separate Sale and Purchase Agreement to acquire RSA’s another 31.41% interest in the issued share capital of CGL and remaining 70% of the outstanding loans advanced by RSA to CGL under the same Loan Agreement mentioned above.

AUDITORS

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Wang Mingcai

Executive Chairman

Hong Kong, 7th April 2003