

The directors submit their report together with the audited accounts for the year ended 31st December 2004.

## 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"), the Sultanate of Oman, Peru, the Azerbaijan Republic, and the Kingdom of Thailand ("Thailand").

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 23.

The directors recommend the payment of a final dividend of HK\$0.035 per share for the year ended 31st December 2004, totalling HK\$165,693,000.

## RESERVES

Movements in the reserves of the Group and the Company during the year are set out in note 24 to the accounts.

## DONATIONS

Charitable and other donations made by the Group during the year amounted to HK\$10,000 (2003: HK\$10,000).

## PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and the Company 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 23 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 68.

## PURCHASE, SALE OR REDEMPTION OF SHARES

During the year, 22,410,000 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") and cancelled, 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\$	
May	<u>22,410,000</u>	0.95	0.89	<u>20,766</u>

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 Cheng Cheng	(appointed on 25th June 2004)
Mr Lin Jingao	
Dr Lau Wah Sum	
Mr Aubrey Li Kwok Sing	
Dr Liu Xiao Feng	(appointed on 16th April 2004)

In accordance with Article 89 & 97 of the Company's Bye-Laws, Mr Cheng Cheng, Mr Aubrey Li Kwok Sing and Dr Lau Wah Sum shall retire at the forthcoming Annual General Meeting and, being eligible, offer themselves 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, Mr Aubrey Li Kwok Sing and Dr Liu Xiao Feng, Independent Non-Executive Directors, were appointed for a two-year term expiring on 31st December 2006, 31st July 2006 and 15th April 2006, respectively.

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 59, 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.

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

Age 42, 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. He joined the Company as Executive Vice-Chairman & Managing Director in January 2001.

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

### **Mr Cheng Cheng** (*Executive Director*)

Age 36, was appointed as an Executive Director in June 2004. He is currently a Deputy General Manager of the Company. Before joining the Company, Mr. Cheng has over 15 years industry experience working at various departments and sections of China National Petroleum Corporation including 3 years in Canada as Vice President of CNPC International (Canada) Limited. Mr. Cheng has a Master of Business Administration from the University of Calgary, Canada, a Master in Energy and Environment Economy from Scuola Superiore Enrico Mattei, Milan Italy and Diploma in Petroleum Technical Economy from Jiangnan Institute of Petroleum, the PRC.

### **Mr Lin Jingao** (*Non-Executive Director*)

Age 60, 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 and Deputy Chief Accountant. From August 1994 to 2002, Mr Lin worked as the Chief Financial Controller and Deputy Director of CNPC's Finance Department, Deputy Section Head and Section Head of Financial Resources Department. In 1997, he joined the Company and CNPC Hong Kong (Holdings) Limited as Non-Executive Director.

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

Age 77, is a Fellow of the Chartered Institute of Management Accountants. He was the Chairman of Urban Renewal Authority. He is currently the President of W S Lau & Associates Limited and Chairman of Equity Holdings Limited. He serves the community as 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 55, 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 ABC Communications (Holdings) Limited, The Bank of East Asia, Limited, Café de Coral Holdings Limited, China Everbright International Limited, Kowloon Development Company Limited, Pokfulam Development Company Limited and Value Partners China Greenchip Fund Limited. He is 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.

### **Dr Liu Xiao Feng** (*Independent Non-Executive Director*)

Age 42, was appointed as an Independent Non-Executive Director of the Company in April 2004. He was a director of NM Rothschild & Sons (Hong Kong) Limited and has over 11 years' experience in investment banking. Mr Liu has a Ph.D and Master from the Faculty of Economics, University of Cambridge and a Bachelor of Economics from Sichuan Institute of Finance and Economics, China.

## Senior Management

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

Age 52, member of Hong Kong Institute of Certified Public 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

No contracts of significance in relation to the Group's business to which the Company, its fellow 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 2004, the interests of the directors and chief executive in the shares of the Company (within the meaning of the Securities and Future Ordinance (the "SFO")), as recorded in the register maintained by the Company under section 352 of the SFO 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 2,549,317,342 shares in the Company as at 31st December 2004. 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 under the executive share option scheme approved by the board of directors on 23rd October 1991 and 3rd June 2002 respectively. 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 chief 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"). No option was granted under the 2001 Share Option Scheme. As at 31st December 2004, options to subscribe for a total of 100,000,000 option shares were still outstanding under the 1991 Share Option Scheme.

**SHARE OPTIONS (continued)**

The following is a summary of the principal terms of share option schemes of the Company (for the 1991 and 2002 Share Option Schemes, only those terms applying to the outstanding option shares are set out below):

**(a) 1991 Share Option Scheme**

The 1991 Share Option Scheme was designed to give executive directors and full-time employees 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 may be issued upon exercise of all outstanding options granted and yet to be exercised under the 1991 Share Option Scheme as at the date of the annual report is 100,000,000, representing approximately 2.1% 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 scheme.

The 1991 Share Option Scheme was terminated on 28th May 2001 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.

**(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 Rules Governing the Listing of Securities on the Stock Exchange (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.

The total number of shares may be issued upon exercise of all outstanding opinions granted and yet to be exercised under the 2002 Share Option Scheme as at the date of the annual report is 32,000,000 representing approximately 0.7% of the issued share capital of the Company as at that date.

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.

## SHARE OPTIONS (continued)

### (b) 2002 Share Option Scheme (continued)

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.

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 Listing Rules:

Name	Date of grant	Exercise price HK\$	Balance at 1st January 2004	Granted during the year	Balance at 31st December 2004	Exercisable period
Directors :						
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	26th April 2001	0.61	10,000,000	–	10,000,000	26th July 2001 to 25th April 2006
Dr Lau Wah Sum	8th January 2004	1.362	–	3,500,000	3,500,000	8th April 2004 to 7th January 2009
Mr Aubrey Li Kwok Sing	8th January 2004	1.362	–	3,500,000	3,500,000	8th April 2004 to 7th January 2009
Mr Cheng Cheng	25th June 2004	0.94	–	20,000,000	20,000,000	25th September 2004 to 24th June 2009
Employee:	25th June 2004	0.94	–	5,000,000	5,000,000	25th September 2004 to 24th June 2009
			<u>100,000,000</u>	<u>32,000,000</u>	<u>132,000,000</u>	

The directors are of the view that the value of the share options granted during the year depends on a number of variables which are either difficult to ascertain or can only be ascertained subject to a number of theoretical bases and speculative assumptions. Accordingly, the directors believe that any calculation of the value of the share options will not be meaningful and may be misleading to shareholders in the circumstances.

## SUBSTANTIAL SHAREHOLDERS

At 31st December 2004, the register of substantial shareholders maintained under section 336 of the SFO shows that the Company had been notified of the following substantial shareholders' interests, being 5% or more of the Company's issued share capital.

Name	Number of shares
Sun World	2,549,317,342 <sup>1</sup>

<sup>1</sup> All 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 2,549,317,342 shares held by Sun World.

Save as disclosed above, no person had any interest or short position in any shares or underlying shares of the Company as recorded in the register kept under section 336 of the SFO.

## 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 Group require disclosure in the annual report of the Group:

- (a) On 25th November 2004, the Company entered into a joint venture agreement (the "Agreement") with Daqing Petroleum Administration Bureau ("Daqing Bureau"), to establish a sino-foreign joint venture company, 青島凱姆拓塑膠工業有限公司 ("the JV Company") in the PRC. As at 31st December 2004, both the Company and Daqing Bureau have contributed US\$3,000,000 (approximately HK\$23,400,000) and US\$9,000,000 (approximately HK\$70,200,000) (representing 25% and 75% interests in the JV Company), respectively, to the registered capital of the JV Company. The JV Company will engage in the production and sale of casting polypropylene ("CPP") film and its related raw materials, including research and development of CPP related products. Daqing Bureau is an operational entity owned and operated by CNPC, the Company's ultimate holding company, and is therefore a connected person of the Company under the Listing Rules.
- (b) On 14th December 2004, the Company contributed an additional RMB65,000,000 (approximately HK\$61,321,000) in cash to the registered capital of 華油鋼管有限公司 ("North China") to finance the setting up of a new branch factory ("Branch Factory") in the Yangzhou Han Jiang Industrial Park, the PRC. The Branch Factory is set up to manufacture and sale of longitudinal welded middle size steel pipes, used for the transportation of natural gas. North China is a jointly controlled entity of the Company where the Company has a 50% direct interest. The remaining interest is owned by 華北石油管理局, 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 27 to the accounts which also constitute connected transactions under Chapter 14 of the Listing Rules. The Independent Non-Executive Directors, Dr Lau Wah Sum, Mr Aubrey Li Kwok Sing and Dr Liu Xiao Feng, have reviewed the above transactions and those disclosed in note 27 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 30 and 31 to the accounts in relation to the management of the 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 existed 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	24%
Percentage of purchases attributable to the Group's five largest suppliers	42%
Percentage of sales attributable to the Group's largest customer	50%
Percentage of sales attributable to the Group's five largest customers	99%

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

None of the directors of the Company is aware of any information which would indicate that the Group is not, or was not, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of the Stock Exchange ("Listing Rules") at any time during the twelve months ended 31st December 2004.

The Board has received from each Independent Non-Executive Director a written annual confirmation of their independence and satisfied their independence up to the approval date of the Company's 2004 Annual Report in accordance with 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. Dr Liu Xiao Feng was admitted to the audit committee after he was appointed as an independent non-executive director during the year. Two meetings were held during the current financial year.

By reference to "A Guide for The Formation of An Audit Committee" published by the Hong Kong Institute of Certified Public 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.



### 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, 25th April 2005