CNOOC LTD
Form 20-F
June 26, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

|_| REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005

OR

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________ to ______________

OR

|_| SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report ______________

Commission File Number 1-14966

CNOOC LIMITED
[CHINESE LANGUAGE OMITTED]
(Exact name of Registrant as specified in its charter)

Hong Kong
(Jurisdiction of incorporation or organization)

65th Floor, Bank of China Tower
One Garden Road, Central
Hong Kong
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each
American depositary shares, each representing 100 shares of par value HK$0.02 per share..	New York St
Shares of par value HK$0.02 per share..	New York St

Securities registered or to be registered pursuant to Section 12(g) of the Act. None (Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. None (Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Shares, par value HK$0.02 per share... 41,054,675,

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes |X| No |_|

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes |X| No |_|

Note - Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant is required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes |X| No |_|

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, nor a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer |X| Accelerated filer |_| Non-accelerated filer |_|

Indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17 |_| Item 18 |X|

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes |_| No |X|

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes |_| No |_|

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* As of December 31, 2005, the number of shares outstanding was 41,054,675,375. As a result of placing existing shares and subscription of new shares as announced by CNOOC (BVI) Limited on April 27, 2006, we allotted 2,272,727,273 new shares on May 11, 2006. The number of shares outstanding immediately after the placing and allotment was 43,327,402,648.

** Not for trading, but only in connection with the registration of American depositary shares.

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PART II

PART III

TERMS AND CONVENTIONS

Definitions

Unless the context otherwise requires, references in this annual report to:

- "CNOOC" are to our controlling shareholder, China National Offshore Oil Corporation, a PRC state-owned enterprise, and its affiliates, excluding us and our subsidiaries;

- "CNOOC Limited," are to CNOOC Limited, a Hong Kong limited liability company and the registrant of this annual report;

- "Our company," "we," "our" or "us" are to CNOOC Limited and its subsidiaries;

- "China" or "PRC" are to the People's Republic of China, excluding for purposes of geographical reference in this annual report, the Hong Kong Special Administrative Region, the Macau Special Administrative Region and Taiwan;

- "Hong Kong Stock Exchange" or "HKSE" are to The Stock Exchange of Hong Kong Limited;

- "Hong Kong Stock Exchange Listing Rules" are to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited;

- "HK$" are to Hong Kong dollar, the legal currency of the Hong Kong Special Administrative Region;

- "JPY" are to Japanese yen, the legal currency of Japan;

- "Rmb" are to Renminbi, the legal currency of the PRC;

- "Rupiah" are to Indonesian Rupiah, the legal currency of the Republic of Indonesia; and

- "US$" are to U.S. dollar, the legal currency of the United States of America.

Conventions

We have translated amounts from Renminbi into U.S. dollars solely for the convenience of the reader at the noon buying rate in New York for cable transfers payable in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York on December 30, 2005 of US$1.00=Rmb 8.0702. We have also translated amounts in Hong Kong dollars solely for the convenience of the reader at the rate of HK$7.80 to US$1.00, the linked exchange rate between such currencies under policies of the Hong Kong government in effect on December 31, 2005. We make no representation that the Renminbi amounts or Hong Kong dollar amounts could have been, or could be, converted into U.S. dollars at those rates on December 31, 2005, or at all. For further information on exchange rates, see Item 3 "Key Information--Selected Financial Data."

Totals presented in this annual report may not total correctly due to rounding of numbers.

Our "average net realized price" for oil and gas in each period is derived from a numerator divided by a denominator, where:

- the numerator is equal to the sum of (i) revenues from our oil and gas sales offshore China for the applicable period; (ii) the 30% ownership share of revenues from gas sales for the applicable period from our associated company, Shanghai Petroleum and Natural Gas Company Limited; and (iii) the revenues from oil and gas sales for the applicable period from our overseas interests; while:

- the denominator is equal to the sum of (i) the volume of oil and gas sales offshore China for the applicable period; (ii) 30% of the volume of gas sales for the applicable period from our associated company, Shanghai Petroleum and Natural Gas Company Limited; and (iii) the volume of oil and gas sales for the applicable period from our overseas interests.

Our "net proved reserves" consist of our percentage interest in reserves, including our 100% interest in the independent oil and gas properties and our participating interest in the properties covered under the production sharing contracts in the PRC, less: (a) an adjustment for our share of royalties payable by us to the PRC government and our participating interest in share oil payable to the PRC government under the production sharing contracts, and (b) an adjustment for production allocable to foreign partners under the PRC production sharing contracts as reimbursement for exploration expenses attributable to our participating interest; and plus (i) our 5.3% participating interest in North West Shelf Project in Australia, and (ii) our participating interest in the properties covered under the production sharing contracts in Indonesia less an adjustment for share oil attributable to the Indonesian government and the domestic market obligation. In this annual report, we use "share oil" to refer to the portion of production that must be allocated to the relevant government entity or company under our production sharing contracts.

Net proved reserves do not include any deduction for production taxes payable by us, which are included in our operating expenses. Net production is calculated in the same way as net proved reserves. Unless otherwise noted, all information in this annual report relating to oil and natural gas reserves is based upon estimates prepared by us. In calculating barrels-of-oil equivalent, or BOE, amounts, we have assumed that 6,000 cubic feet of natural gas equals one BOE, with the exception of natural gas from certain fields which is converted using the actual heating value of the natural gas.

Glossary of Technical Terms

Unless otherwise indicated in the context, references to:

- "API gravity" means the American Petroleum Institute's scale for specific gravity for liquid hydrocarbons, measured in degrees. The lower the API gravity, the heavier the liquid and, generally, the lower its commercial value. For example, asphalt has an API gravity of eight degrees, West Texas Intermediate, a benchmark crude oil, has an API of 40 degrees, and gasoline has an API gravity of 50 degrees.

- "appraisal well" means an exploration well drilled after a successful wildcat well to gain more information on a newly discovered oil or gas reserve.

- "condensate" means light hydrocarbon liquids separated from natural gas in the field through condensation when natural gas is exposed to surface temperature and pressure. This group generally includes slightly heavier hydrocarbons than natural gas liquids, such as pentane. It is combined with crude oil production and reserve figures.

- "crude oil" means crude oil and liquids, including condensate, natural gas liquids and liquefied petroleum gas.

- "development cost" means, for a given period, costs incurred to obtain access to proved reserves and to provide facilities for extracting, treating, gathering and storing the oil and gas.

- "dry hole" means an exploration well that is not commercial (i.e., economically feasible to develop). Dry hole costs include the full costs for such drilling and are charged as an expense.

- "exploration well" means a wildcat or appraisal well.

- "lifting cost" means, for a given period, costs incurred to operate and maintain wells and related equipment and facilities, including applicable operating costs of support equipment and facilities and other costs of operating and maintaining those wells and related equipment and facilities, plus production taxes. Also known as production cost. The U.S. dollar amount of the lifting cost in this annual report may be different from what we disclosed in Hong Kong annual report due to the usage of different conversion rates.

- "natural gas liquids" means light hydrocarbons that can be extracted in liquid form from natural gas through special separation plants. This group includes typically lighter liquid hydrocarbons than condensate, such as butane, propane and ethane. It is combined with crude oil production but not with crude oil reserve figures.

- "net wells" means a party's working interest in wells.

- "proved developed reserves" means proved reserves of oil and natural gas that can be expected to be recovered through existing wells with existing equipment and operating methods.

- "proved reserves" means estimated quantities of crude oil and natural gas that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made.

- "proved undeveloped reserves" means proved reserves that are expected to be recovered from new wells in undrilled areas, or from existing wells where significant expenditure is required for completion.

For further definitions relating to reserves:

- "reserve replacement ratio" means, for a given year, total additions to proved reserves divided by production during the year.

- "reserve-to-production ratio" means the ratio of proved reserves to annual production of crude oil or, with respect to natural gas, to wellhead production excluding flared gas.

- "seismic data" means data recorded in either two-dimensional (2D) or three-dimensional (3D) form from sound wave reflections off of subsurface geology. This is used to understand and map geological structures for exploratory purposes to predict the location of undiscovered reserves.

- "success" means a discovery of oil or gas by an exploration well. Such an exploration well is a successful well and is also known as a discovery. A successful well is commercial, which means there are enough hydrocarbon deposits discovered for economical recovery.

- "success rate" means the total number of successful exploration wells divided by the total number of exploration wells drilled in a given period. Success rate can be applied to wildcat wells or appraisal wells in general.

- "wildcat well" means an exploration well drilled in an area or rock formation that has no known reserves or previous discoveries.

References to:

- bbls means barrels, which is equivalent to approximately 0.134 tons of oil (33 degrees API);

- mmbbls means million barrels;

- BOE means barrels-of-oil equivalent;

- BOE per day means barrels-of-oil equivalent per day;

- million BOE means million barrels-of-oil equivalent;

- mcf means thousand cubic feet;

- mmcf means million cubic feet;

- bcf means billion cubic feet, which is equivalent to approximately 283.2 million cubic meters;

- BTU means British Thermal Unit, a universal measurement of energy; and

- km means kilometers, which is equivalent to approximately 0.62 miles.

FORWARD-LOOKING STATEMENTS

This annual report includes "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this annual report that address activities, events or developments which we expect or anticipate will or may occur in the future are forward-looking statements. The words "believe," "intend," "expect," "anticipate," "project," "estimate," "predict" and similar expressions are also intended to identify such forward-looking statements.

These forward-looking statements address, among others, such issues as:

- the amount and nature of future exploration, development and other capital expenditures,

- wells to be drilled or reworked,

- oil and gas prices and demand,
- future earnings and cash flow,
- development projects,
- exploration prospects,
- estimates of proved oil and gas reserves,
- potential reserves,
- development and drilling potential,
- drilling prospects,
- expansion and other development trends of the oil and gas industry,
- business strategy,
- production of oil and gas,
- development of undeveloped reserves,
- expansion and growth of our business and operations, and
- our estimated financial information.

These statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate under the circumstances. However, whether actual results and developments will meet our expectations and predictions depend on a number of risks and uncertainties which could cause our actual results, performance and financial condition to differ materially from our expectation. For a description of such risks and uncertainties, see "Item 3-Key Information-Risk Factors."

Consequently, all of the forward-looking statements made in this annual report are qualified by these cautionary statements. We cannot assure that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected effect on us or our business or operations.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable, but see "Item 6--Directors, Senior Management and Employees--Directors and Senior Management."

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

You should read our selected historical consolidated financial data set forth below in conjunction with our consolidated financial statements and their notes under "Item 18--Financial Statements" and "Item 5--Operating and Financial Review and Prospects" in this annual report.

On June 6, 2002, Ernst & Young replaced Arthur Andersen & Co as our independent public accountants. For a discussion on such change of accountants, see "Item 3--Key Information--Risk Factors--Risks relating to our business--You may not be able to assert claims against Arthur Andersen, our independent public accountants for periods prior to 2002, nor may you be able to assert claims against our current independent public accountants for financial statements previously audited by Arthur Andersen" and "Item 5--Operating and Financial Review and Prospects--Change of Accountants."

The Hong Kong Institute of Certified Public Accountants issued a number of new standards and interpretations, effective January 1, 2005, which are applicable to our financial statements for the fiscal year ended on December 31, 2005. Certain prior year amounts have been restated upon adoption of such new policies, details of which are included in note 2.4 to our consolidated financial statements under "Item 18--Financial Statements" in this annual report.

We have prepared and presented our consolidated financial statements in accordance with Hong Kong generally accepted accounting principles ("Hong Kong GAAP"). For an explanation of the reconciliation of our net income and shareholders' equity to U.S. generally accepted accounting principles ("US GAAP"), see note 37 to our consolidated financial statements under "Item 18--Financial Statements" in this annual report.

	Year ended December			
	2001(g)	2002	2003	
	Rmb	Rmb	Rmb	
	(in millions, except per share a			
Income Statement Data:				
Hong Kong GAAP		(Restated)	(Restated)	(Rest
Operating revenues:				
Oil and gas sales..........................	17,561	23,779	28,117	3
Marketing revenues.........................	2,537	2,377	12,399	1
Other income...............................	722	217	434	
Total operating revenues...................	20,820	26,374	40,950	5
Expenses:				
Operating expenses.........................	(2,329)	(3,775)	(4,513)	(5

Production taxes	(884)	(1,023)	(1,239)	(1
Exploration expenses	(1,039)	(1,318)	(848)	(1
Depreciation, depletion and amortization	(2,567)	(4,020)	(4,643)	(5
Dismantlement	(90)	(126)	(167)	
Impairment losses related to property, plant and equipment	--	--	--	
Crude oil and product purchases	(2,453)	(2,326)	(12,295)	(17
Selling and administrative expenses	(616)	(1,033) (e)	(1,250) (e)	(1,104
Others	(618)	(31)	(350)	
	(10,596)	(13,652)	(25,305)	(32
Interest income	318	148	184	
Finance costs	(117)	(295)	(355)	
Exchange gains (losses), net	235	(114)	(7)	
Short term investment income	221	193	124	
Share of profits of associates	90	165	220	
Non-operating income (expenses), net	35	(71)	315	
Income before tax	11,006	12,748	16,125	2
Tax	(3,048)	(3,541)	(4,628)	(6
Net income	7,958	9,207	11,497	1
Net income per share (basic)(a)(b)	0.20	0.22	0.28	
Net income per share (diluted)(a)(c)	0.20	0.22	0.28	
Net income per ADS (basic)(a)(b)	20.04	22.42	27.99	
Net income per ADS (diluted)(a)(c)	20.04	22.40	27.97	
Dividend per share(a)				
Special interim dividend declared in place of 2003 final dividend(d)	--	--	--	
Interim	0.022	0.024	0.030	
Interim (in US$)	0.003	0.003	0.004	
Special interim	--	--	0.038	
Special interim (in US$)	--	--	0.005	
Proposed final(d)	0.032	0.032	0.026	
Proposed final (in US$)(d)	0.004	0.004	0.003	
Proposed special final(d)	--	0.032	0.038	
Proposed special final (in US$)(d)	--	0.004	0.005	
U.S. GAAP Operating revenues:				
Oil and gas sales	17,561	23,779	28,117	3
Marketing revenues	2,537	2,377	12,399	1
Other income	722	217	434	
Total operating revenues	20,820	26,374	40,950	5
Net Income	7,920	9,086	11,980	1
Net income per share (basic)(a)(b)	0.20	0.22	0.29	
Net income per share (diluted)(a)(c)	0.20	0.22	0.29	

Year ended December

	2001(g)	2002	2003
	Rmb	Rmb	Rmb
	(in millions, except per share a		
Net income per ADS (basic)(a)(b)...............	19.95	22.12	29.17
Net income per ADS (diluted)(a)(c).............	19.95	22.13	29.14

As of December 31,

	2001(g)	2002	2003	
	Rmb	Rmb	Rmb	
	(in millions)			
Balance Sheet Data:				
Hong Kong GAAP		(Restated)	(Restated)	
Cash and cash equivalents......................	6,394	7,839	14,400	
Time deposits with maturities over three months.	2,050	4,690	2,323	
Short term investments.........................	8,896	6,531	5,684	
Current assets.................................	20,030	24,486	29,263	
Property, plant and equipment, net.............	23,828	35,797 (f)	42,849 (f)	
Investment in associates.......................	462	537	1,118	
Intangible assets..............................	--	--	--	
Long term available-for-sale financial assets...	--	--	--	
Total assets...................................	44,320	60,820 (f)	73,229 (f)	
Current liabilities............................	4,392	7,134	9,307	
Long term bank loans, net of current portion....	3,256	941	890	
Long term guaranteed notes	--	4,071	8,142	
Total long term liabilities....................	6,617	13,393	17,461	
Total liabilities..............................	11,009	20,527	26,768	
Shareholders' equity...........................	33,311	40,293 (e),(f)	46,461 (e),(f)	56,4
U.S. GAAP				
Total assets...................................	44,062	60,444	73,234	
Total long term liabilities....................	6,617	13,393	17,461	
Shareholders' equity...........................	33,053	40,344	46,496	

(a) On March 17, 2004, our shareholders approved a five-for-one stock split of our shares. The stock split was effected by dividing each of our issued and unissued shares of HK$0.10 each into five shares of HK$0.02 each, and to increase the board lot size for trading on the Hong Kong Stock Exchange from 500 shares of HK$0.10 each to 1,000 subdivided shares of HK$0.02 each. The ratio of our ADSs listed on the New York Stock Exchange also changed such that each ADS now represents 100 subdivided shares of HK$0.02 each, as opposed to 20 shares of HK$0.10 each prior to the stock split. As such, per share amounts of our shares have been adjusted retroactively for the stock split.

(b) Net income per share (basic) and net income per ADS (basic) for 2001 have been computed, without considering the dilutive effect of the shares underlying our share option scheme, by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 39,706,916,525 and 397,069,165 respectively (based on a ratio of 100 shares to one ADS) for the period. Net income per share (basic) and net income per ADS (basic) for 2002 have been computed, without considering the dilutive effect of the shares underlying our share option scheme, by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 41,070,828,275 and 410,708,283 respectively (based on a ratio of 100 shares to one ADS) for the period. Net income per share (basic) and net income per ADS (basic) for 2003 have been computed, without considering the dilutive effect of the shares underlying our share option scheme, by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 41,070,828,275 and 410,708,283 respectively (based on a ratio of 100 shares to one ADS) for the period. Net income per share (basic) and net income per ADS (basic) for 2004 have been computed, without considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 41,060,240,659 and 410,602,407 respectively (based on a ratio of 100 shares to one ADS) for the period. Net income per share (basic) and net income per ADS (basic) for 2005 have been computed, without considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 41,054,499,982 and 410,545,000 respectively (based on a ratio of 100 shares to one ADS) for the period.

(c) Net income per share (diluted) and net income per ADS (diluted) for 2001 have been computed, after considering the dilutive effect of the shares underlying our share option scheme, using 39,711,444,015 and 397,114,440 respectively. Net income per share (diluted) and net income per ADS (diluted) for 2002 have been computed, after considering the dilutive effect of the shares underlying our share option scheme, using 41,096,426,920 and 410,964,269 respectively. Net income per share (diluted) and net income per ADS (diluted) for 2003 have been computed, after considering the dilutive effect of the shares underlying our share option scheme, by using 41,110,339,095 and 411,103,391 respectively. Net income per share (diluted) and net income per ADS (diluted) for 2004 have been computed, after considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by using 41,179,513,436 and 411,795,134 respectively. Net income per share (diluted) and net income per ADS (diluted) for 2005 have been computed, after considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by using 42,386,055,766 and 423,860,558 respectively.

(d) The proposed final dividend and special final dividend for 2003 were cancelled and replaced by the special interim dividend of HK0.06 per share declared and paid in 2004.

(e) In periods prior to 2005, no recognition and measurement of share-based transactions in which employees (including directors) were granted share options in our company were required until such options were exercised by the employees, at which time the share capital and share premium were credited with the proceeds received. In 2005, we have adopted the provisions of Hong Kong Financial Reporting Standard ("HKFRS") retrospectively to all stock options granted from the date of our incorporation. Under HKFRS 2, when employees (including directors) render services as consideration for equity transactions ("equity-settled transaction"), the cost of equity-settled transaction is measured by reference to the fair value on the date on which the instrument is granted.

(f) Certain prior year amounts have been restated upon adoption of new Hong Kong accounting policies, details of which are included in note 2.2 to our financial statements (under HK GAAP). In prior periods, we classified the on-shore processing plants as land and buildings and depreciated over 30-50 years on a straight-line basis. Upon the adoption of HKAS 16, we have retrospectively reclassified our property, plant and equipment into two categories: oil and gas properties, and vehicles and office equipment. We have reclassified the onshore terminals previously classified as land and buildings to oil and gas properties as they will be used in similar operations and are expected to have similar economic useful lives. We have also changed our accounting policy retrospectively for 2002, 2003 and 2004 to state the onshore terminals at cost instead of valuation and to amortize those terminals by the unit-of-production method on a property-by-property basis.

(g) The 2001 selected consolidated income statement data and consolidated balance sheet data were audited by Arthur Anderson & Co., which voluntarily relinquished its license to practice public accounting in 2002. Our current auditors, Ernst & Young, have not reaudited the financial statements of 2001. As such, no restatement was made for 2001 as the impacts on the consolidated financial statements are considered not material.

	Year ended December			
	2001(g)	2002	2003	
	Rmb	Rmb	Rmb	
Other Financial Data:				
Hong Kong GAAP				
Capital expenditures paid........................	4,343	6,833	8,272	1
Cash provided by (used for):				
Operating activities.......................	11,759	14,742	17,819	2
Investing activities.......................	(11,366)	(11,724)	(9,513)	(24
Financing activities.......................	3,204	(1,573)	(1,745)	
Ratio of total debt to total capitalization(1).............................	12.3%	11.6%	16.2%	
U.S. GAAP				
Cash provided by (used for):				
Operating activities.......................	11,759	14,742	17,819	2
Investing activities.......................	(11,366)	(11,724)	(9,513)	(24
Financing activities.......................	3,204	(1,573)	(1,745)	
Ratio of cash provided by operating activities to gross interest expense(2)......	37.2x	36.4x	35.1x	
Ratio of total debt to cash provided by operating activities............................	0.4x	0.4x	0.5x	
Net income......................................	7,920	9,086	11,980	1
Net income margin(3)............................	38.0%	34.5%	29.3%	
Ratio of net income to gross interest expense(2).	25.1x	22.4x	23.6x	
Ratio of total debt to net income...............	0.6x	0.6x	0.8x	
Ratio of total debt to total capitalization(1)...	12.4%	11.8%	16.3%	

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(1) Total capitalization excludes current portion of long-term debt.

(2) Gross interest expense includes capitalized interest.

(3) Net income margin represents net income as a percentage of our total operating revenues, as computed under U.S. GAAP.

We publish our financial statements in Renminbi. Unless otherwise indicated, all translations from Renminbi to U.S. dollars have been made at a rate of Rmb 8.0702 to US$1.00, the noon buying rate as certified for customs purposes by the Federal Reserve Bank of New York on December 30, 2005. We do not represent that Renminbi or U.S. dollar amounts could be converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rate below or at all.

The following table sets forth the noon buying rates for U.S. dollars in New York City for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York for the periods indicated:

	Noon Buying Rate			
Period	End	Average(1)	High	Low
		(Rmb per US$1.00)		
2001	8.2766	8.2772	8.2786	8.2676
2002	8.2800	8.2772	8.2800	8.2669
2003	8.2767	8.2771	8.2800	8.2765
2004	8.2765	8.2768	8.2774	8.2764
2005	8.0702	8.1998	8.2765	8.0702
December 2005	8.0702	--	8.0808	8.0702
January 2006	8.0608	--	8.0702	8.0596
February 2006	8.0415	--	8.0616	8.0415
March 2006	8.0167	--	8.0505	8.0167
April 2006	8.0165	--	8.0248	8.0040
May 2006	8.0215	--	8.0300	8.0005

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(1) Determined by averaging the noon buying rates on the last business day of each month during the relevant period.

As of June 6, 2006, the noon buying rate for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York was Rmb 8.0120 to US$1.00.

The Hong Kong dollar is freely convertible into the U.S. dollar. Since 1983, the Hong Kong dollar has been linked to the U.S. dollar. The Hong Kong government has also stated that it has no intention of imposing exchange controls in Hong Kong and that the Hong Kong dollar will remain freely convertible into other currencies, including the U.S. dollar. However, we cannot assure that the Hong Kong government will maintain the link at HK$7.80 to US$1.00 or at all.

The following table sets forth the noon buying rates for U.S. dollars in New York City for cable transfers in Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York for the periods indicated.

Period	Noon Buying Rate End	Average(1)	High	Low
	(HK$ per US$1.00)			
2001	7.7980	7.7996	7.8004	7.7970
2002	7.7988	7.7996	7.8095	7.7970
2003	7.7640	7.7864	7.8001	7.7285
2004	7.7723	7.7891	7.8010	7.7632
2005	7.7533	7.7755	7.7999	7.7514
December 2005	7.7533	--	7.7548	7.7514
January 2006	7.7561	--	7.7571	7.7506
February 2006	7.7584	--	7.7618	7.7564
March 2006	7.7597	--	7.7620	7.7570
April 2006	7.7529	--	7.7598	7.7529
May 2006	7.7567	--	7.7575	7.7510

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(1) Determined by averaging the noon buying rates on the last business day of each month during the relevant period.

As of June 6, 2006, the noon buying rate for cable transfers in Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York was HK$7.7596 to US$1.00.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Risks relating to our business

Our business, revenues and profits fluctuate with changes in oil and gas prices

Even relatively modest declines in crude oil prices may adversely affect our business, revenues and profits. Our profitability is determined in large part by the difference between the prices received for the crude oil we produce and the costs of exploring for, developing, producing and selling these products.

Prices for crude oil fluctuate widely in response to relatively minor changes in the supply and demand for oil, market uncertainty and various other factors that are beyond our control, including:

- political developments in petroleum producing regions;
- the ability of the Organization of Petroleum Exporting Countries and other petroleum producing nations to set and maintain production levels and prices;

o the price and availability of other energy sources, such as coal;

o domestic and foreign government regulations;

o weather conditions; and

o overall economic conditions.

Our revenues and net income have increased significantly in the past five years, mainly due to increasing oil prices. However, we can not assure that oil price will remain high in the future. In 2005, oil prices for West Texas Intermediate, the international benchmark for crude oil, rose 44.9% from US$42.13 per barrel on January 3, 2005 to US$61.04 per barrel on December 30, 2005. The conflict and turmoil in the Middle East in the past three years raised concerns about the security and availability of ample supplies to meet growing global demand. West Texas Intermediate reached a high in 2005 of US$69.82 per barrel on August 30, 2005 and was US$72.50 per barrel on June 6, 2006. For a description of oil prices in recent years, see "Item 4--Information on the Company--Business Overview--Sales and Marketing--Sales of Offshore Crude Oil--Pricing" in this annual report. Any future declines in oil and gas prices would adversely affect our revenues and net income.

The prices for the natural gas we sell are determined by negotiations between us and the prospective buyers. Our typical contracts with gas buyers include provisions for periodic resets and adjustment formulas that depend on a basket of crude oil prices and inflation as well as various other factors. These resets and adjustment formulas can result in natural gas price fluctuations which may adversely affect our business, results of operations and financial condition.

Lower oil and gas prices may result in the write-off of higher cost reserves and other assets and may lower our earnings or cause losses. Lower oil and natural gas prices may also reduce the amount of oil and natural gas we can produce economically and render existing contracts that we have entered into uneconomical. For further details regarding the effects of oil and gas price fluctuations on our financial condition and results of operations, see "Item 5--Operating and Financial Review and Prospects."

The oil and gas reserve estimates in this annual report may require substantial revision as a result of future drilling, testing and production

The reliability of reserves estimates depends on a number of factors, including:

o the quality and quantity of technical and economic data;

o the prevailing oil and gas prices for our production;

o the production performance of reservoirs;

o extensive engineering judgments; and

o royalty and share oil policies in the PRC and foreign countries and regions where we have operations or assets.

Many of the factors, assumptions and variables involved in estimating reserves are beyond our control and may prove to be incorrect over time. Consequently, the results of drilling, testing and production may require substantial upward or downward revisions in our initial reserves data. For more information on our oil and gas reserves data, see "Item 4--Information on the Company--Business Overview--Oil and Natural Gas Reserves."

Any failure to develop our proved undeveloped reserves and gain access to additional reserves could impair our ability to achieve certain growth objectives

Our ability to achieve certain growth objectives depends upon our success in finding and acquiring or gaining access to additional reserves. Future drilling, exploration and acquisition activities may not be successful. If our exploration and development activities or acquisition of properties containing proved reserves are unsuccessful, our total proved reserves will decline.

Approximately 50.9% of our proved reserves were undeveloped as of December 31, 2005. Our future success will depend on our ability to develop these reserves in a timely and cost-effective manner. There are various risks in developing reserves, including construction, operational, geophysical, geological and regulatory risks.

Our future prospects largely depend on our capital expenditure plans, which are subject to various risks

The oil and gas exploration and production business is capital intensive. We currently plan to spend US$2,233.2 million to develop our oil and gas properties and US$457.8 million for exploration in 2006. In addition to these amounts, we may make additional capital expenditures and investments to implement our business strategy.

The ability to maintain and increase our revenues, net income and cash flows depends upon continued capital spending. We adjust our capital expenditure and investment budget each year. Our capital expenditure plans are subject to a number of contingencies, some of which are beyond our control. These variables include:

- our ability to generate sufficient cash flows from operations to finance our capital expenditures, investments and other requirements;

- the availability and terms of external financing;

- changes in crude oil and natural gas prices, which may affect cash flows from operations and capital expenditure and investment plans;

- the mix of exploration and development activities conducted on an independent basis and under production sharing contracts;

- new investment opportunities that may be presented to us, including international investment opportunities and liquefied and other natural gas projects;

- approvals required from foreign governments for certain capital expenditures and investments outside the PRC;

- our ability to obtain sufficient foreign currency to finance our capital expenditures; and

- economic, political and other conditions in the PRC and in foreign countries and regions where we have operations.

Therefore, our actual capital expenditures and investments in the future may differ significantly from our current planned amounts. There can be no assurance that we will be able to execute our capital expenditure program on schedule or as planned.

Any failure to implement our natural gas business strategy may adversely affect our business and financial position

As part of our business strategy and to meet increasing market demand in China, we continue to expand our natural gas business. This strategy involves a number of risks and uncertainties including the following:

- we have limited experience in investing in liquefied natural gas facilities, gas transmission and distribution systems, and overseas upstream natural gas properties;

- any additional capital expenditures that are necessary to implement our natural gas strategy could divert resources from our core oil and gas exploration and production business and require us to seek additional financing;

- our new natural gas operations may face additional competition from a number of international and PRC companies. In particular, PetroChina Company Limited, or PetroChina, has constructed natural gas pipelines to link its natural gas fields located in the western part of China to the eastern coastal regions;

- our new natural gas activities may subject us to additional government regulation in China and foreign countries and regions;

- our overseas natural gas businesses are subject to economic and political risks in the relevant countries and regions. See "--We are exposed to operating risks in some foreign countries and regions as a result of our acquisition of oil and gas interests located in these regions;"

- we do not have the same preferential rights or access to natural gas businesses or overseas natural gas investments that we enjoy with respect to our upstream natural gas business offshore China; and

- we are evaluating the options to invest in CNOOC's liquefied natural gas projects in China. However, we have not decided whether to exercise these options. The options are subject to various conditions, including the receipt of certain governmental approvals.

Due to the above factors or other reasons, we may fail to implement our natural gas strategy successfully.

The infrastructure and demand for natural gas in the PRC may proceed at a slower pace than our planned increase in production

Our proposed expansion of natural gas production in China is currently constrained by a lack of natural gas transmission and supply infrastructure and an underdeveloped natural gas market. Construction of transmission and supply pipelines and other infrastructure depends on many factors, many of which are beyond our control, such as funding, costs of land acquisition, national and local government approvals, and timely completion of construction. Development of the natural gas market depends on the establishment of long-term natural gas supply contracts with natural gas utilities or large end-users, such as power and chemical plants. The demand of these buyers for natural gas could be affected by a number of regulatory and market factors, such as regulation of coal prices, government power and utility policies, chemical commodity cycles, electricity pricing and demand, and environmental policies.

CNOOC largely controls us and we regularly enter into related party transactions with CNOOC and its affiliates

CNOOC indirectly owned 66.41% of our shares as of June 6, 2006. As a result, CNOOC is able to control the composition of our board of directors, determine the timing and amount of our dividend payments and otherwise control us. Although CNOOC is required to comply with provisions in the Hong

Kong Stock Exchange Listing Rules relating to protection for minority shareholders, there can be no assurance that CNOOC will act in a manner that benefits all of our shareholders. If CNOOC takes actions that favor its interests over ours, our results of operations and financial position may be adversely affected. We regularly enter into transactions with CNOOC and its affiliates, including China Oilfield Services Limited and Offshore Oil Engineering Company Limited. For the year ended December 31, 2005, sales to CNOOC and its affiliates accounted for 38.3% of our total revenues. For further details, see "Item 7--Major Shareholders and Related Party Transactions." Our transactions with CNOOC and its affiliates constitute connected transactions under the Hong Kong Stock Exchange Listing Rules. However, We must obtain the prior approval of the Hong Kong Stock Exchange to engage in some of these transactions and may also be required to obtain the prior approval of our independent directors and our independent shareholders. If we do not obtain these approvals, we may not be allowed to execute these transactions and our business operations and financial condition could be adversely affected.

Under current PRC law, CNOOC has the exclusive right to enter into production sharing contracts with foreign oil and gas companies for petroleum exploration and production offshore China. CNOOC has undertaken to us that it will transfer all of its rights and obligations under any new production sharing contracts to us, except those relating to its administrative functions. PRC law restricts us from contracting directly with foreign enterprises for these purposes without CNOOC. The interests of CNOOC in entering into production sharing contracts with international oil and gas companies may differ from our interests, especially with respect to the criteria for determining whether, and on what terms, to enter into production sharing contracts. Our future business development may be adversely affected if CNOOC does not enter into new production sharing contracts on terms that are acceptable to us.

Our business performance relies heavily on our sales to several major customers and a substantial drop in sales to any of these customers could have a material adverse effect on our results of operations

We sell a significant proportion of our production to CNOOC and its affiliates and China Petroleum & Chemical Corporation, or Sinopec. For the years ended December 31, 2003, 2004 and 2005, sales to CNOOC and its affiliates accounted for 20.3%, 25.3% and 38.3%, respectively, of our total operating revenues, while sales to Sinopec accounted for 17.0%, 19.3% and 22.5%, respectively, of our total operating revenues. CNOOC has a controlling interest in us. However, our transactions with CNOOC and its affiliates are on commercial terms and CNOOC does not guarantee our sales volume or profit margin. Sinopec has its own oil and gas fields and has the right to import crude oil directly from the international market. We do not have any long-term sales contracts with CNOOC and its affiliates or Sinopec. Our business, results of operations and financial condition would be adversely affected if either CNOOC and its affiliates or Sinopec significantly reduces their crude oil purchases from us and we cannot find another ready buyer in the international market to purchase our crude oil at comparable prices.

The PRC petroleum and natural gas industries are highly competitive and our success depends on several factors

We compete in the PRC and international markets for customers, capital financing and business opportunities, including desirable oil and gas prospects. The performance of our competitors may also affect the international market price for comparable crude oil, which in turn would likely affect the price of our crude oil. Our principal competitors in the PRC market are PetroChina and Sinopec. For further details, see "Item 4--Information on the Company--Business Overview--Competition."

We are the dominant player in the oil and gas industry offshore China. Currently, we are the only company permitted to engage in oil and gas exploration offshore China in cooperation with foreign oil and gas companies. Any change to PRC law that allows new entrants to conduct oil and gas exploration activities offshore China in cooperation with international oil and gas companies could increase the competition for new oil and gas properties offshore China.

CNOOC has undertaken to us that so long as it retains a controlling interest in us and our securities are listed on the Hong Kong Stock Exchange, the New York Stock Exchange or other securities

trading systems in other parts of the world, we will have the exclusive right to exercise CNOOC's rights to engage in offshore oil and gas exploration, development, production and sales in the PRC and that it will not compete with us in such business. However, CNOOC's controlling interest in us may not continue in the future and CNOOC's undertaking may be subject to interpretative challenges. See "Item 4--Information on the Company--History and Development--Corporate Structure" and "Item 7--Major Shareholders and Related Party Transactions."

Exploration, development and production risks and natural disasters affect our operations and could result in losses that are not covered by insurance

Our petroleum exploration, development and production operations are subject to various risks, including pipeline ruptures and spills, fires, explosions, encountering formations with abnormal pressures, blowouts, cratering and natural disasters. Any of these risks could result in loss of hydrocarbons, environmental pollution and other damage to our properties and the properties of operators under production sharing contracts. In addition, we face the risk that we may not discover any economically productive natural gas or oil reservoirs. The costs of drilling, completing and operating wells also are uncertain and are subject to numerous factors beyond our control, including:

- weather conditions;
- natural disasters;
- availability of equipment and services;
- equipment shortages and delays; and
- lack of adequate transportation facilities.

We maintain insurance coverage against some, but not all, potential losses. We do not maintain business interruption insurance for all of our oil and gas fields. We may suffer material losses resulting from uninsurable or uninsured risks or insufficient insurance coverage.

For further information on insurance coverage, see "Item 4--Information on the Company--Business Overview--Operating Hazards and Uninsured Risks."

Some foreign countries and regions in which we have operations or may have operations in the future may not have diplomatic or trade relations with other countries and may be subject to trade or economic sanctions imposed by such other countries

We currently have operations and assets in various foreign countries and regions, including Indonesia, Australia, Canada, Morocco, Nigeria and Myanmar. We may expand our operations into other countries to further enhance our reserve base and diversify our geographic risk profile. While these countries in which we have operations or may have operations in the future may maintain an amicable relationship with China, some of them may not have diplomatic or trade relations with other countries and may be subject to trade or economic sanctions imposed from time to time by such other countries. We will endeavor to limit our investment and scale of operations in these foreign jurisdictions to minimize our exposure, but we cannot assure that the operations and assets that we currently have or in the future may have in foreign countries and regions will not be affected by trade or economic sanctions that may be imposed by other countries due to their deteriorated relations with each other. Our business and results of operations may be adversely affected if such sanctions are imposed and result in interruption of our overseas operations or non-accessibility of our overseas assets for a significant period of time.

We are exposed to operating risks in some foreign countries and regions as a result of our acquisition of oil and gas interests located in these regions

We have acquired interests in oil and gas properties located in various foreign countries and regions, including Indonesia, Australia, Canada, Morocco, Nigeria and Myanmar. See "Item 4--

Information on the Company--Business Overview--Principal Oil and Gas Regions--Overseas Activity," "--Natural Gas Business--Overseas Activity" and

"Item 5--Operating and Financial Review and Prospects--Operating Results--Acquisitions and Overseas Activities." These interests are subject to operating risks in their respective regions, including economic and political risks.

Our non-PRC interests are subject to the laws and regulations of these non-PRC jurisdictions respectively, including those relating to the development, production, marketing, pricing, transportation and storage of crude oil and natural gas, taxation and environmental and safety matters. In addition, our overseas operations generally are subject to production sharing arrangements with production sharing partners. As we expand to different countries, we may become exposed to various operating risks in each of these jurisdictions. Our non-PRC interests may be adversely affected by changes in governmental policies or social instability or other political, economic or diplomatic developments in or affecting these foreign nations which are not within our control including, among other things, a change in crude oil or natural gas pricing policy, the risks of war and terrorism, expropriation, nationalization, renegotiation or nullification of existing concessions and contracts, taxation policies, foreign exchange and repatriation restrictions, changing political conditions, foreign exchange rate fluctuations and currency controls.

We may not be able to obtain external financing that is acceptable to us for business development purposes

From time to time, we may need to procure external debt and equity financing to implement our development plans and fund our other business requirements.

Our ability to obtain external financing is subject to various uncertainties, including:

- our results of operations, financial condition and cash flows;

- the amount of capital that other PRC and Hong Kong entities may seek to raise in the international capital markets;

- economic, political and other conditions in the PRC and Hong Kong;

- the PRC government's policies relating to foreign currency borrowings; and

- conditions in the PRC, Hong Kong and international capital markets.

If we are unable to obtain sufficient funding for our operations or development plans, our business, revenues, net income and cash flows could be adversely affected. For additional information on our capital expenditure plans and financing requirements, see "Item 5--Operating and Financial Review and Prospects--Liquidity and Capital Resources."

Once we issue debt securities or otherwise incur indebtedness, we become subject to risks that impact the underlying principal of such indebtedness. While all our current debt securities are rated investment grade by rating agencies, we cannot assure that such ratings will not change due to internal or external factors. These factors may be beyond our control. Even if there is no default or event of default on our part, a market perception of an increased likelihood of a default may have a material adverse effect on our outstanding indebtedness as well as on our business operations.

You may not be able to assert claims against Arthur Andersen, our independent public accountants for periods prior to 2002, nor may you be able to assert claims against our current independent public accountants for financial statements previously audited by Arthur Andersen

On June 6, 2002, we terminated the engagement of Arthur Andersen & Co as our independent public accountants. Prior to that date, Arthur Andersen had audited our financial statements. Our selected historical financial data for the year ended, and as of, December 31, 2001 set forth in "Item 3--Key Information--Selected Financial Data" were based on our financial statements audited by Arthur Andersen. On June 15, 2002, Arthur Andersen was convicted of federal obstruction of justice charges in

connection with the U.S. government's investigation of Enron Corporation. On August 31, 2002, Arthur Andersen voluntarily relinquished its licenses to practice public accountancy in all states of the United States, thereby effectively ceasing to exist as a global accounting firm. Accordingly, it may be difficult or impossible for you to assert any claims against, or recover any damages from, Arthur Andersen, in respect of this annual report, including in respect of the financial statements previously audited by Arthur Andersen. Moreover, our current independent public accountants, Ernst & Young, have not reaudited the financial statements previously audited by Arthur Andersen. Therefore, it is highly unlikely that you will be able to assert claims against, or recover any damages from, Ernst & Young, in respect of the financial statements that were previously audited by Arthur Andersen.

Risks relating to the PRC petroleum industry

A change in PRC petroleum industry regulations could have an adverse effect on our operations

The PRC government exercises control over the PRC petroleum industry, including with respect to licensing, exploration, production, distribution, pricing, taxation, imports and exports and allocation of various resources. In the past, we have benefited from various favorable PRC government policies, laws and regulations that have been enacted to encourage the development of the offshore petroleum industry. See "Item 4--Information on the Company--Regulatory Framework--Special Policies Applicable to the Offshore Petroleum Industry in China." We cannot assure that the legal regime affecting our businesses will remain substantially unchanged or that we will continue to benefit from favorable PRC government policies.

In addition, existing PRC regulations require us to apply for and obtain various PRC government licenses and other approvals, including in some cases approvals for amendments and extensions of existing licenses and approvals, to conduct exploration and development activities offshore China. If we are unable to obtain any necessary approvals, our reserves and production would be adversely affected. See "Item 4--Information on the Company--Regulatory Framework."

Increasing competition from foreign companies as a result of China's entry into the World Trade Organization may adversely affect our business

Effective December 11, 2001, the PRC became a member of the World Trade Organization, or WTO. China's WTO commitments require it, within five years from the date of China's accession to the WTO, to lift restrictions that prohibit foreign companies from directly selling crude and processed oil in China. The sale of natural and liquefied petroleum gas is not specifically dealt with under China's market-access commitments relating to distribution services (as is the case with crude and processed oil). On April 6, 2004, the PRC Ministry of Commerce promulgated the Measures for the Administration on Foreign Investment in Commercial Fields, which generally allow foreign companies, through foreign-invested enterprises, to engage in retail and wholesale businesses other than those subject to special administration by the PRC government such as direct sale of crude and processed oil in China. The lifting of the restrictions on distribution of natural liquefied petroleum gas and the subsequent lifting of the restrictions on distribution of crude and processed oil in accordance with China's WTO commitments may increase competition and may adversely affect our business.

We may be penalized if we fail to comply with existing or future environmental laws and regulations

Our business is subject to environmental protection laws and regulations in the PRC, as well as other jurisdictions, which, among other things:

- impose fees for the discharge of waste substances;

- require the payment of fines and damages for serious environmental pollution; and

- provide that the government may, at its discretion, close or suspend any facility which fails to comply with orders requiring it to cease or cure operations causing environmental damage.

We believe that all of our facilities and operations are in material compliance with the requirements of the relevant environmental protection laws and regulations. However, amendment of existing laws or regulations may impose additional or more stringent requirements. In addition, our compliance with such laws or regulations may require us to incur significant capital expenditures or other obligations or liabilities, which could create a substantial financial burden on us. For a further discussion of the environmental regulations, particularly those in the PRC, see "Item 4--Information on the Company--Business Overview--Environmental Regulation."

Risks relating to the PRC

PRC economic and political conditions may adversely affect our operations

Most of our businesses, assets and operations are located in the PRC. The economic system of the PRC differs from the economies of most developed countries in many respects, including:

- government investment;

- level of development;

- control of capital investment;

- control of foreign exchange; and

- allocation of resources.

The economy of the PRC has been undergoing a transformation from a planned economy to a market-oriented economy. In recent years the PRC government has implemented economic reform measures emphasizing decentralization, utilization of market forces in the development of the PRC economy and a higher level of management autonomy. These economic reform measures have and will continue to subject our businesses to some uncertainty. In the future, our operating results could be adversely affected by changes to the laws and regulations that govern our industry and changes in the PRC political and economic systems.

The PRC economy has experienced significant growth since 1978, but the growth has been uneven both geographically and among various sectors of the economy. The PRC government has implemented various policies from time to time to restrain the rate of such economic growth, control inflation and otherwise regulate economic expansion. In addition, the PRC government has attempted to control inflation by controlling the prices of basic commodities. Severe measures or other actions by the PRC government, such as placing additional controls on prices of petroleum and petroleum products, could restrict our business operations and adversely affect our financial position.

Government control of currency conversion and future movements in exchange rates may adversely affect our operations and financial condition

A portion of our Renminbi revenue may need to be converted into other currencies by our wholly owned principal operating subsidiary in the PRC to meet our foreign currency obligations. We have substantial requirements for foreign currency, including:

- debt service on foreign currency denominated debt;
- overseas acquisitions of oil and gas properties;
- purchases of imported equipment; and

- payment of dividends declared in respect of shares held by international investors.

Our wholly owned subsidiary in the PRC may undertake current account foreign exchange transactions without prior approval from the State Administration for Foreign Exchange. It has access to current account foreign exchange so long as it can produce commercial documents evidencing such transactions and provided that they are processed through certain banks in China. Foreign exchange transactions under the capital account, including principal payments with respect to foreign currency denominated obligations, will be subject to the registration requirements of the State Administration for Foreign Exchange.

The value of the Renminbi against Hong Kong dollar, U.S. dollar and other currencies fluctuates and is affected by, among other things, changes in China's political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the People's Bank of China. The official exchange rate for the conversion of Renminbi into U.S. dollar has generally been stable during the past 10 years. On July 21, 2005, China reformed its foreign exchange regime by moving into a managed floating exchange rate system based on market supply and demand with reference to a basket of currencies. Renminbi would no longer be pegged to the U.S. dollar. From that day to December 31, 2005, Renminbi appreciated about 2.5% against the U.S. dollar. Changes in the PRC government's currency policies may lead to further fluctuations in the exchange rates for the conversion of Renminbi into foreign currencies which could have an uncertain effect on our business and operating results.

For further information on foreign exchange risks, foreign exchange rates and hedging activities, see "Item 3--Key Information--Selected Financial Data" and "Item 11--Qualitative and Quantitative Disclosure about Market Risk." However, we may be unable to hedge our exposure to foreign currencies fully and future Renminbi exchange rate movements could adversely affect our results of operations and financial condition. Since we receive substantially all of our revenues and express our profits in Renminbi, any devaluation of the Renminbi may also materially and adversely affect the value of, and any dividends payable on our shares and American depositary shares in foreign currency terms.

Certain legal restrictions on dividend distribution may have a material adverse effect on our cash flows

We are a holding company. Our exploration, development, production and sales businesses are owned and conducted through various wholly owned subsidiaries, including CNOOC China Limited, our wholly foreign-owned enterprise in the PRC. Accordingly, our future cash flows will consist principally of dividends from our subsidiaries. The subsidiaries' ability to pay dividends to us is subject to PRC regulations, including restriction that companies may pay dividends only out of net income determined in accordance with PRC accounting standards and regulations. In addition, under PRC laws, CNOOC China Limited is required to allocate at least 10% of its net profit to a reserve fund until the balance of the fund has reached 50% of its registered capital. Such reserve is not distributable as cash dividends. Therefore, there is a risk that we could not maintain sufficient cash flows due to these restrictions on dividend distribution.

The interpretation and enforcement of PRC laws and regulations is subject to some uncertainty

The PRC legal system is based on statutory law. Under this system, prior court decisions may be referred to but are not binding. Since 1979, the PRC government has been developing a comprehensive system of commercial laws and considerable progress has been made in the promulgation of laws and regulations dealing with economic matters, such as corporate organization and governance, foreign investments, commerce, taxation and trade. Because these laws, regulations and legal requirements are relatively new, and because of the limited volume of published cases and judicial interpretations and the non-binding nature of prior court decisions, the interpretation and enforcement of these laws, regulations and legal requirements involve some uncertainty.

The PRC government underwent substantial reforms after the National People's Congress meeting in March 2003. The PRC government has reiterated its policy of furthering reforms in the

socialist market economy. No assurance can be given that these changes will not have an adverse effect on business conditions in China generally or on our business in particular.

Risks relating to our ADSs and shares

Additional shares or ADSs eligible for public sale could adversely affect the price of our shares or ADSs

Sales, or the real or perceived possibility of sales, of a significant number of additional shares in the public market could adversely affect prevailing market prices for our shares and ADSs. As of June 6, 2006, CNOOC, through its wholly owned subsidiaries, CNOOC (BVI) Limited and Overseas Oil & Gas Corporation Ltd., held approximately 66.41% of our shares and the rest of our shares were held by public investors, including institutional and corporate investors. We cannot predict the effect, if any, that sales of our shares, including sales of large positions held by institutional and corporate investors, or the availability of our shares for future sale, will have on the market price of our shares or ADSs.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT

Our legal and commercial name is CNOOC Limited. We were incorporated with limited liability on August 20, 1999 in Hong Kong under the Companies Ordinance of Hong Kong. Our business registration number in Hong Kong is 685974. Under the third section of our Memorandum of Association, we may do anything which we are permitted to do by any enactment or rule of law. Our head office is located at 65th Floor, Bank of China Tower, One Garden Road, Central, Hong Kong, and our telephone number is 852-2213-2500. We have appointed CT Corporation System, 111 Eighth Avenue, New York, New York 10011, as our agent for service of process.

The PRC government established CNOOC, our controlling shareholder, as the state-owned offshore petroleum company of China in 1982 under the Regulation of the People's Republic of China on Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises, whereby CNOOC assumed overall responsibility for the administration and development of PRC offshore petroleum operations with foreign oil and gas companies. Prior to March 2003, CNOOC was regulated and supervised by the State Economic and Trade Commission. Since March 2003, the PRC government has undergone substantial reform. The National Development and Reform Commission has succeeded the State Economic and Trade Commission as the primary coordinator for the petroleum industry.

Prior to CNOOC's internal business reorganization in 1999, CNOOC and its various affiliates performed both commercial and administrative functions relating to petroleum exploration and development offshore China, including:

- exercising the exclusive right to cooperate with foreign partners in offshore petroleum exploration, development, production and sales activities, and taking participating interests in production sharing contracts;

- organizing international bidding for offshore petroleum exploitation;

- conducting independent exploration, development, production and sales activities in independently operated oil and gas fields offshore China;

- awarding projects to and signing bilateral contracts with foreign partners for offshore petroleum exploitation;

- reviewing and confirming appraisal reports and overall development plans required under production sharing contracts; and

- obtaining from the PRC government all approvals, permits, licenses, consents and special policies necessary under production sharing contracts.

Reorganization

Pursuant to CNOOC's internal business reorganization in 1999, CNOOC transferred all of its then and current operational and commercial interests in its offshore petroleum business to us. As a result, we and our subsidiaries are the only vehicle through which CNOOC engages in petroleum exploration, development, production and sales activities both within and outside China.

The assets and liabilities primarily relating to the offshore petroleum business that were transferred to us in the reorganization included:

- 37 production sharing contracts and one geophysical survey agreement;

- 8 independent development and production projects;

- a 30% interest in Shanghai Petroleum and Natural Gas Company Limited;

- the land use rights to terminal facilities in Nanhai, Weizhou and the western part of the Bohai Bay; and

- loans from, and swap agreements with, various PRC and foreign banks.

In addition, CNOOC transferred 917 employees to us to facilitate the transfer of the oil and natural gas businesses previously operated by CNOOC.

CNOOC retained its commercial interests in operations and projects not related to oil and gas exploration and production, including:

- a petrochemical project in Huizhou, Guangdong Province;

- a fertilizer plant in Hainan Province; and

- a liquefied natural gas project in Guangdong Province.

CNOOC also retained all of its administrative functions, which it performed prior to the reorganization, including:

- organizing international bidding for offshore petroleum exploitation;

- awarding projects to and signing bilateral contracts with foreign partners for offshore petroleum exploitation;

- approving any extension of the period for the completion of the appraisal work on petroleum discovery under the production sharing contracts; and

- submitting the overall development plans, reports of the oil and gas fields and the environmental impact statements related to the production sharing contracts to the PRC governmental authorities.

Undertakings

CNOOC has undertaken to us that:

- o we will enjoy the exclusive right to exercise all of CNOOC's commercial and operational rights under the PRC laws and regulations relating to the exploration, development, production and sales of oil and natural gas offshore China;
- o it will transfer to us all of CNOOC's rights and obligations under any new production sharing contracts and geophysical exploration operations, except those relating to CNOOC's administrative functions;
- o it will not engage or be interested, directly or indirectly, in oil and natural gas exploration, development, production and sales in or outside the PRC;
- o we will be able to participate jointly with CNOOC in negotiating new production sharing contracts and to set out our views to CNOOC on the proposed terms of new production sharing contracts;
- o we will have unlimited and unrestricted access to all data, records, samples and other original data owned by CNOOC relating to oil and natural gas resources;
- o we will have an option to make investment in liquefied natural gas projects that CNOOC invested or proposed to invest, and CNOOC will at its own expense help us to procure all necessary government approvals needed for our participation in these projects; and
- o we will have an option to participate in other businesses related to natural gas in which CNOOC invested or proposed to invest, and CNOOC will procure all necessary government approvals needed for our participation in such business.

The undertakings from CNOOC will cease to have any effect:

- o if we become a wholly owned subsidiary of CNOOC;
- o if our securities cease to be listed on any stock exchange or automated trading system; or
- o 12 months after CNOOC or any other PRC government-controlled entity ceases to be our controlling shareholder.

Organizational Structure

CNOOC indirectly owned or controlled an aggregate of approximately 66.41% of our shares as of June 6, 2006. There have been no changes to our corporate structure since such date. Accordingly, CNOOC continues to be able to exercise all the rights of a controlling shareholder, including electing our directors and voting to amend our articles of association. Although CNOOC has retained a controlling interest in us, the management of our business will be our directors' responsibility.

The following chart sets forth our controlling entities and our principal subsidiaries as of June 6, 2006.


```
                                                   --------------------------
                                                    China National Offshore
                                                        Oil Corporation
                                                             (PRC)
                                                   --------------------------
                                                               |
                                                               |  100%
                                                               |
                                                   --------------------------
                                                      Overseas Oil & Gas
                                                      Corporation, Ltd(1)
                                                           (Bermuda)
                                                   --------------------------
                                                               |
                                                               |  100%
                                                               |
                                                   --------------------------
                                                      CNOOC (BVI) Limited
                                                    (British Virgin Islands)

                                                   --------------------------
              --------------------------                      |
               Public Shareholders and                        |
                 Corporate Investors    \                     |    66.41%
                                          \  33.59%           |
              --------------------------    \                 |
                                              \    --------------------------
                                                \       CNOOC Limited
                                                  \      (Hong Kong)

                                                   --------------------------
                                                              |
                                                              |
                                                              |
                ----------------------------------------------------------------------------------
                |                            |                                  |
                |   100%                     |   100%                           |   100%
                |                            |                                  |
   --------------------------   --------------------------         --------------------------    -
             CNOOC
         International                  CNOOC China                    China Offshore Oil
           Limited(2)                    Limited(3)                        (Singapore)
    (British Virgin Islands)               (PRC)                   International Pte. Ltd.(4)
                                                                           (Singapore)
   --------------------------   --------------------------         --------------------------    -
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(1) Overseas Oil & Gas Corporation, Ltd also directly owns five shares of our company.

(2) Owner of our overseas interests in petroleum exploration and production businesses and operations.

(3) Owner of substantially all of our PRC petroleum exploration and production businesses, operations and properties.

(4) Business vehicle through which we engage in sales and marketing activities in the international markets.

(5) Include CNOOC Finance (2002) Limited, the financing vehicle through which we issued our US$500 million 6.375% guaranteed notes due 2012, CNOOC Finance (2003) Limited, the financing vehicle through which we issued our US$200 million 4.125% guaranteed notes due 2013 and US$300 million 5.5% guaranteed notes due 2033, and CNOOC Finance (2004) Limited, the financing vehicle through which we issued our US$1 billion zero coupon guaranteed convertible bonds due 2009. These finance companies are our wholly owned subsidiaries with our company as their sole corporate director.

Capital Expenditures

Our capital expenditures in 2003, 2004 and 2005 amounted to Rmb 12,372.5 million, Rmb 18,622.0 million and Rmb 17,469.5 million (US$2,164.7 million) , respectively. For 2006, we have budgeted approximately US$3.08 billion for capital expenditures, approximately US$316.3 million of which is budgeted for general exploration activities offshore China and approximately US$1,860.1 million is budgeted for development activities offshore China. We expect to fund our capital expenditures with our cash flows from operations and our borrowings. For further details about our capital expenditures, see "Item 5--Operating and Financial Review and Prospects--Liquidity and Capital Resources--Capital Expenditures and Investments."

B. BUSINESS OVERVIEW

Overview

We are an oil and gas company engaged in the exploration, development and production of crude oil and natural gas primarily offshore China. We are the dominant producer of crude oil and natural gas offshore China and the only company permitted to conduct exploration and production activities with foreign oil and gas companies offshore China. As of December 31, 2005, we had estimated net proved reserves of 2,362.6 million BOE, comprised of 1,457.4 million barrels of crude oil and condensate and 5,430.9 billion cubic feet of natural gas. For 2005, our net production averaged 356,868 barrels per day of

crude oil, condensate and natural gas liquids and 389.6 million cubic feet per day of natural gas, which together totaled 424,108 BOE per day.

Our net proved reserves increased from 1,787.1 million BOE as of December 31, 2001 to 2,362.6 million BOE as of December 31, 2005 which represents a compound annual growth rate of 7.2%. Based on net proved reserves, we are one of the largest independent oil and gas exploration and production companies in the world. In the petroleum industry, an "independent" company owns oil and gas reserves independently of other downstream assets, such as refining and marketing assets, whereas an integrated company owns downstream assets in addition to oil and gas reserves. As of December 31, 2005, approximately 50.9% of our net proved reserves were classified as net proved undeveloped. We plan to spend US$1,860.1 million developing our reserves primarily offshore China and US$316.3 million for exploration primarily offshore China in 2006.

We conduct exploration, development, production and sale activities through both independent operations and production sharing contracts with foreign partners. We have added to our reserves in recent years primarily through our independent operations. As of December 31, 2005, independent properties accounted for 61.9% of our total net proved reserves and independent net proved undeveloped reserves accounted for 67.2% of our total net proved undeveloped reserves. We are the operator of all of our independent producing properties. For the year ended December 31, 2005, production from our independent properties accounted for 45.5% of our total net production.

Our controlling shareholder, CNOOC, has the exclusive right to enter into contracts with international oil and gas companies to conduct exploration and production activities offshore China. Under these production sharing contracts, we have the sole right to acquire, at no cost, participating interests in any successful discovery offshore China made by our foreign partners. Our foreign partners can recover their exploration costs under the production sharing contracts only if a commercially viable discovery is made. As of December 31, 2005, we had approximately 28 foreign partners under our existing production sharing contracts offshore China, all of which are international oil and gas companies, including Agip, BP, Burlington Resources, Chevron, ConocoPhillips, Devon Energy, Husky, Kerr-McGee, Newfield Exploration and Royal Dutch Shell. As of December 31, 2005, we were a party to 34 production sharing contracts offshore China. We are currently the operator or joint operator of most of the properties developed under our production sharing contracts.

Natural gas is becoming an increasingly important part of our business strategy because of rapidly growing domestic demand. In view of increasing demand for natural gas, we have continued to develop our natural gas reserves and invested in liquefied natural gas related upstream projects outside the PRC. We continue to explore for natural gas and develop natural gas properties. We have acquired interests in gas reserves located in Tangguh, Indonesia and the North West Shelf of Australia. In addition, CNOOC, our controlling shareholder, has granted us an option to invest in liquefied natural gas projects or other natural gas related business in which CNOOC invested or proposed to invest. The terms of this option require us, if we exercise the option, to reimburse CNOOC for any contribution CNOOC has made with respect to the facility together with interest calculated at the prevailing market rate.

Competitive Strengths

We believe that our historical success and future prospects are directly related to a combination of our strengths, including the following:

- large proved reserve base with significant exploitation opportunities;
- sizable operating areas with demonstrated exploration potential;
- successful independent exploration and development record;
- competitive cost structure;
- reduced risks and access to capital and technology through production sharing contracts;

- strategic position in China's growing natural gas markets; and
- experienced management team.

Large proved reserve base with significant exploitation opportunities

Based on net proved reserves as of December 31, 2005 and average net daily production for the year ended December 31, 2005, we had a reserve-to-production ratio of 15.3 years. As of December 31, 2005, approximately 50.9% of our net proved reserves were classified as net proved undeveloped. We expect our production to grow significantly as these undeveloped properties begin production.

Sizable operating area with demonstrated exploration potential

The offshore China exploration area is approximately 1.3 million square kilometers in size, about twice as large as the U.S. Gulf of Mexico exploration area. Only limited exploration has been conducted in Western South China Sea and East China Sea. Since CNOOC's inception in 1982 to the end of 2005, a total of 820 exploration wells have been drilled offshore China, including 526 wildcat wells with a success rate of approximately 35%. During the past five years ended December 31, 2005, we made 31 discoveries and foreign partners announced 17 discoveries offshore China.

Successful independent exploration and development record.

From the inception of CNOOC in 1982 to December 31, 2005, we achieved a success rate of approximately 44% on our 237 offshore China independent wildcat wells, while our foreign partners achieved a success rate of approximately 28% on their 289 offshore China wildcat wells. As of December 31, 2005, independent properties accounted for 61.9% of our total net proved reserves and independent net proved undeveloped reserves accounted for 67.2% of our total net proved undeveloped reserves. In 2005, we completed four of our major independent development projects on time and under budget.

Competitive cost structure

For the year ended December 31, 2005, our total offshore China lifting costs were US$6.34 per BOE. Total lifting costs for independent operations offshore China were US$5.86 per BOE during the same period. Lifting costs consist of operating expenses and production taxes. We have kept our offshore China lifting costs low through various measures including more efficient use of existing offshore facilities, the linking of employee bonuses to cost reduction and the adoption of new technology in our operations. We believe that such cost structure allows us to compete effectively even in a low crude oil price environment.

Reduced risks and access to capital and technology through production sharing contracts

Production sharing contracts help us minimize our offshore China finding costs, exploration risks and capital requirements because our foreign partners are responsible for all costs associated with exploration. Our foreign partners recover their exploration costs only if a commercially viable discovery is made.

Strategic position in China's growing natural gas markets

The proximity of our natural gas reserves to the major demand areas in the coastal regions of China provides us with a competitive advantage over other natural gas suppliers in China, whose natural gas reserves are located primarily in northwest and southwest China. We have natural gas fields near many of China's rapidly growing coastal areas, including Hong Kong, Shanghai and Guangzhou. We have also acquired interests in gas reserves located in Tangguh, Indonesia and the North West Shelf of Australia. In addition, CNOOC has granted us an option to invest in liquefied natural gas projects or other natural gas related businesses in the PRC in which CNOOC invested or proposed to invest. For further information, see "--Natural Gas Business."

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Experienced management team

Our senior management team has extensive experience in the oil and gas industry, and most of our executives have been with the CNOOC group since its inception in 1982. We evolved from a company heavily reliant on production sharing contracts with foreign partners to a company with a balance of both independent and production sharing contract operations. Our management team and staff have had the opportunity to work closely with foreign partners both within and outside China. We have implemented international management practices including incentive compensation schemes for our employees. In addition, we have adopted share option schemes for our employees. See "Item 6--Directors, Senior Management and Employees--Share Ownership."

Business Strategy

We intend to continue expanding our oil and gas exploration and production activities and, where appropriate, to continue making strategic investments in natural gas businesses. While our expansion strategy will continue to focus primarily on offshore China, we may also consider overseas acquisition opportunities that may be presented to us. The principal components of our strategy are as follows:

- increase production primarily through the development of our net proved undeveloped reserves;
- add to our reserves through independent exploration and production sharing contracts;
- capitalize on the growing demand for natural gas in China;
- selectively pursue acquisitions to ensure long-term production growth, geographical reserves risk diversification, and to further our natural gas strategy;
- maintain operational efficiency and low production costs; and
- maintain financial flexibility through prudent financial practices.

Increase production primarily through the development of our net proved undeveloped reserves

As of December 31, 2005, approximately 50.9 % of our proved reserves were classified as net proved undeveloped, which gives us the opportunity to achieve substantial production growth even without additional reserve discoveries, assuming that we will be able to develop these reserves more quickly than we deplete our currently producing reserves. We are currently undertaking a number of large development projects located primarily in the Bohai Bay and the Western South China Sea, which we expect to substantially increase production. We plan to spend approximately US$1,860.1 million in 2006 to develop our net proved undeveloped reserves offshore China. We also plan to spend approximately US$373.1 million to develop our overseas reserves in 2006.

Add to our reserves through independent exploration and production sharing contracts

We plan to concentrate our independent exploration efforts in existing operating areas. We plan to spend approximately US$457.8 million in 2006 on exploration activities. We plan to increase independent exploration efforts while continuing to enter into production sharing contracts with foreign partners to lower capital requirements and exploration risks. In 2006, we plan to drill approximately 67 exploration wells, and acquire independently approximately 25,300 kilometers and 4,050 square kilometers of 2D seismic data and 3D seismic data, respectively. Our foreign partners under existing production sharing contracts plan to drill approximately 22 exploration wells, and acquire approximately 13,200 kilometers and 5,320 square kilometers of 2D seismic data and 3D seismic data, respectively, in 2006.

Capitalize on the growing demand for natural gas in China

We plan to capitalize on the growth potential of the PRC natural gas market through the following initiatives:

- continue to develop natural gas fields and focus independent exploration efforts on natural gas;
- evaluate whether to exercise the options to invest in CNOOC's liquefied natural gas projects in China; and
- evaluate investment opportunities in related natural gas businesses that will help develop markets for our natural gas production.

To the extent we invest in businesses and geographic areas where we have limited experience and expertise, we plan to structure our investments as alliances or partnerships with parties possessing the relevant experience and expertise.

Selectively pursue acquisitions to ensure long-term production growth, geographical reserves risk diversification, and to further our natural gas strategy

We plan to make selective acquisitions that will meet one or more of our strategic objectives of enhancing our production profile, diversifying our reserve base and geographic risk profile and furthering our natural gas strategy. In addition, we evaluate acquisition opportunities based on our expected economic return criteria. In 2004 and 2005, we, Golden Aaron Pte. Ltd. and China Global Construction Limited. formed a joint venture and entered into six production sharing contracts with Myanmar Oil and Gas Enterprise. We act as the operator under these production sharing contracts. In early 2005, through our wholly owned subsidiary CNOOC Canada Limited, we acquired a 16.69% interest in MEG Energy Corp. at a consideration of 150 million Canadian dollars. In April 2006, we completed the acquisition of a 45% working interest in an offshore oil-mining license "OML 130" in Nigeria for a cash consideration of US$2.268 billion. On April 28, 2006, through our wholly-owned subsidiary CNOOC Africa Limited, we signed production sharing contracts for six blocks with a total area of 115,343 square kilometers in Kenya.

We are continuously implementing our natural gas strategy. In April, 2006, we signed Farm-in Agreements with BHP Billiton Limited and Kerr-McGee Australia Exploration and Production Pty Ltd through our subsidiary, CNOOC Australia E&P Pty Ltd, and obtained a 25% interest in four Exploration Permits in the Outer Browse Basin of Australia. We believe these upstream participation will enhance our natural gas strategy as well as provide us with access to other gas-rich basins for further growth opportunities.

Maintain operational efficiency and low production costs

We will continue to maintain our low cost structure and operational efficiency through the following initiatives:

- Apply up-to-date drilling, production and offshore engineering technology to our operations through our oilfield service providers. This technology includes long-range extension wells, multilateral wells, advanced formation testing, multi-phase transmission, monolayer pipeline and subsea technology, minimal structure techniques and suction foundation technology;

- Proactively manage service contracts and cooperate with our oilfield service providers to improve exploration efficiency and reduce exploration costs. This measure includes using operational techniques such as cluster drilling, which reduces drilling time by one-third and lowers the related costs by up to 40%; and

- Maintain high production volume levels on an individual well basis and increase the productivity of producing wells.

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Maintain financial flexibility through prudent financial practices

Currently, we have a strong financial profile with a low leverage ratio. We intend to maintain our financial strength by managing key measures such as capital expenditures, cash flows and fixed charge coverage. We intend to actively manage our accounts receivable and inventory positions to enhance liquidity and improve profitability. We will continue to monitor our foreign currency denominated debt and to minimize our exposure to foreign exchange rate fluctuations.

Selected Operating and Reserves Data

The following table sets forth our operating data and our net proved reserves as of the time and for the periods indicated.

	Year ended December 31,		
	2003	2004	2005
Net Production:			
Oil (daily average bbls/day)..................	306,464	319,436	356,868
Gas (daily average mmcf/day)..................	291.0	364.1	389.6

Oil equivalent (BOE/day)	356,729	382,513	424,108
Average net realized prices:			
Oil (per bbl)	US$28.11	US$35.41	US$47.31
Gas (per mcf)	2.87	2.75	2.82
Offshore China lifting costs (per BOE)	4.66	5.31	6.34
Overseas lifting costs (per BOE)(1)	9.27	10.72	12.41
Net Proved Reserves (end of period):			
Oil (mmbbls)	1,436.1	1,455.6	1,457.4
Gas (bcf)	4,154.4	4,646.6	5,430.9
Total (million BOE)	2,128.5	2,230.0	2,362.6
Proved developed reserves (million BOE)	914.6	1,080.7	1,159.8
Annual reserves replacement ratio	187%	173%	186%
Estimated reserves life (years)	16.3	15.9	15.3
Standardized measure of discounted future net cash flow (million Rmb)	109,800	125,387	199,427

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(1) Overseas lifting costs reflect lifting costs associated with our operations in Indonesia and are calculated using the net entitlement method.

Our finding and development costs per BOE reported in prior years was calculated by dividing the net reserve change for each reporting period (excluding production and sales) into the costs incurred for the period, as reported in the "Costs Incurred" disclosure required by Statement of Financial accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities." Due to the timing of the related costs incurred to find and develop such proved reserves, this often includes quantities of proved reserves for which a majority of the costs of development have not yet been incurred. Conversely, it also often includes costs to develop proved reserves that had been added in earlier years. Because it may not necessarily represent total finding and development costs for projects under way or may not be indicative of expected future finding and development costs, we discontinued reporting such information.

At our request, Ryder Scott Company, an independent petroleum engineering consulting company, carried out an independent evaluation of the reserves of selected properties as of December 31, 2003, 2004 and 2005. For further information regarding our reserves, see "Item 3--Key Information--Risk Factors--Risks relating to our business--The oil and gas reserve estimates in this annual report may require substantial revision as a result of future drilling, testing and production" and "--Oil and Natural Gas Reserves."

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The following table sets forth summary information with respect to our estimated net proved reserves of crude oil and natural gas as of the dates indicated.

	Net proved reserves at December 31,		Net proved res at December 31	
	2003	2004	Developed	Undev
Bohai Bay:				

Crude oil (mmbbls)	990.4	974.6	452.0	
Natural gas (bcf)	566.6	706.2	304.4	
Total (million BOE):	1,084.8	1,092.3	502.7	
Independent (million BOE)	556.3	605.5	336.0	
Production sharing contracts (million BOE)	528.5	486.8	166.7	
Western South China Sea:				
Crude oil (mmbbls)	173.7	189.7	77.6	
Natural gas (bcf)	2,564.0	2,484.8	1,733.5	
Total (million BOE):	601.0	603.8	366.5	
Independent (million BOE)	476.7	482.6	264.7	
Production sharing contracts (million BOE)	124.3	121.2	101.8	
Eastern South China Sea:				
Crude oil (mmbbls)	154.8	168.0	112.0	
Natural gas (bcf)	548.2	730.8	--	
Total (million BOE):	246.1	289.8	112.0	
Independent (million BOE)	141.1	183.8	39.6	
Production sharing contracts (million BOE)	105.0	106.0	72.4	
East China Sea:				
Crude oil (mmbbls)	13.9	21.5	2.8	
Natural gas (bcf)	275.3	403.4	60.0	
Total (million BOE):	59.8	88.7	12.8	
Independent (million BOE)	12.7	88.7	12.8	
Production sharing contracts (million BOE)	47.1	--	--	
Overseas:				
Crude oil (mmbbls)	103.4	101.9	77.1	
Natural gas (bcf)	200.3	321.4	532.4	
Total (million BOE):	136.8	155.5	165.8	
Independent (million BOE)	--	--	--	
Production sharing contracts (million BOE)	136.8	155.5	165.8	
Total:				
Total crude oil (mmbbls)	1,436.1	1,455.6	721.5	
Total natural gas (bcf)	4,154.3	4,646.6	2,630.3	2
Total (million BOE):	2,128.5	2,230.0	1,159.9	1
Independent (million BOE)	1,186.9	1,360.5	653.2	
Production sharing contracts (million BOE)	941.6	869.5	506.7	

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New Contracts Signed in 2005

In 2005, our controlling shareholder, CNOOC, signed seven petroleum contracts offshore China as follows:

No.	Basin	Block	Partner	Interest of Partner(s) in th Exploration Phas (%)
1	Pearl River Mouth Basin	43/11	Kerr-McGee China Petroleum Ltd.	100%
2	East China Sea	25/34	Primeline Energy China Limited/ Primeline Petroleum Corporation	100%
3	Pearl River Mouth Basin	28/20	Texas American Resources-Asia, Inc.	100%
4	Pearl River Mouth Basin	03/27	Texas American Resources-Asia, Inc.	100%
5	Pearl River Mouth Basin	42/05	Devon Energy China, Ltd.	100%
6	Pearl River Mouth Basin	16/05	New Field China, LDC	100%
7	Pearl River Mouth Basin	17/08	New Field China, LDC	100%

In 2005 and the first four months of 2006, we signed 11 overseas petroleum contracts or agreements as follows:

No.	Country	Block	Partners	Our Participat Interest (%)
1	Myanmar	C1	Golden Aaron Pte Limited HQCEC	81.25
2	Myanmar	C2	Golden Aaron Pte Limited HQCEC	81.25
3	Myanmar	M2	Golden Aaron Pte Limited HQCEC	81.25
4	Equatorial Guinea	S	GEPetrol	75
5	Morocco	RAS TAFELNEY	Vanco	11.25
6	Nigeria	OML130	Total Petrobras SAPETRO	45

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7	Nigeria	OPL229	EERL AMNI AERD BOGI	35
8	Philippines	SC57	PNOC-EC	51
9	Australia	WA-301-P	BHPB	25
10	Australia	WA-303-P WA-304-P WA-305-P	BHPB Kerr McGee	25
11	Kenya	Block 1, Block 9, Block 10A, L2, L3, L4		100

Exploration and Production

Summary

We currently conduct exploration, development and production activities primarily in four areas offshore China:

- the Bohai Bay;
- the Western South China Sea;
- the Eastern South China Sea; and
- the East China Sea.

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[GRAPHIC OMITTED]

In addition, we hold several equity interests in oil and gas properties in foreign countries and regions including Indonesia, Australia, Canada, Morocco, Nigeria and Myanmar. See "--Overseas Activity," "--Natural Gas Business--Overseas Activity" and "Item 5--Operating and Financial Review and Prospects--Operating Results--Acquisitions and Overseas Activities."

As of December 31, 2005, we had estimated net proved reserves of 2,362.6 million BOE, comprised of 1,457.4 million barrels of crude oil and condensate and 5,430.9 billion cubic feet of natural gas. As of December 31, 2005, we had interests in 41 producing properties and 49 properties under development and appraisal offshore China. In 2005, seven properties offshore China commenced production. For 2005, net production averaged 356,868 barrels per day of crude oil, condensate and natural gas liquids and 389.6 million cubic feet per day of natural gas, which together totaled 424,108 BOE per day, representing a 10.9% increase over the annual average daily production for 2004.

We conduct our exploration, development and production activities independently as well as through production sharing contracts with foreign partners. A production sharing contract contains provisions regarding the exploration, development, production and operation of an oil and gas field and the formula through which foreign partners may recover exploration, development and production costs and share in the production after the successful development of petroleum reserves. See "--Production Sharing Contracts--Offshore China" for a detailed discussion of these arrangements.

We also conduct exploration efforts through geophysical survey agreements with foreign companies. These geophysical survey agreements allow international oil and gas companies to conduct geophysical studies before deciding whether to negotiate a production sharing contract with CNOOC. If a foreign partner decides to enter into a production sharing contract with CNOOC, the costs and expenses that the foreign partner incurs in conducting geophysical exploration may be recovered during the production period by the foreign partner, subject to our confirmation. See "--Geophysical Survey Agreements" for a detailed discussion of these arrangements. As of December 31, 2005, we were not a party to any geophysical survey agreements, although we may enter into such agreements in the future.

The offshore China exploration area is approximately 1.3 million square kilometers in size. We currently have rights to operate independently or in conjunction with international oil and gas companies in 134 exploration blocks covering approximately 627,271 square kilometers. We have access to 902,476 kilometers of 2D seismic data and 45,217 square kilometers of 3D seismic data. From the beginning of CNOOC's operations in 1982 to December 31, 2005, a total of 820 exploration wells have been drilled, including 526 wildcat wells, with a success rate of approximately 35%. During this period we achieved a success rate of approximately 44% on 237 independent exploration wildcat wells, while our foreign partners achieved a success rate of approximately 28% on their 289 exploration wildcat wells.

Oil and Natural Gas Reserves

We have a large base of net proved undeveloped reserves as a result of our exploration successes. As of December 31, 2005, approximately 50.9% of our net proved reserves were classified as net proved undeveloped. We are undertaking a number of large development projects located primarily in the Bohai Bay and the Western South China Sea and expect these projects to substantially increase our production.

Our "net proved reserves" consist of our percentage interest in reserves, including our 100% interest in the independent oil and gas properties and our participating interest in the properties covered under the production sharing contracts in PRC, less: (a) an adjustment for our share of royalties payable by us to the PRC government and our participating interest in share oil payable to the PRC government under the production sharing contracts, and (b) an adjustment for production allocable to foreign partners under the PRC production sharing contracts as reimbursement for exploration expenses attributable to our participating interest; and plus (i) our 5.3% participating interest in North West Shelf Project in Australia, and (ii) our participating interest in the properties covered under the production sharing contracts in Indonesia less an adjustment for share oil attributable to the Indonesian government and the domestic market obligation. Net proved reserves do not include any deduction for production taxes, which are included in our operating expenses. Net production is calculated in the same way as net proved reserves.

We explore and develop our reserves offshore China under exploration and production licenses granted by the PRC government. The PRC government generally grants exploration licenses for individual blocks while production licenses generally are granted for individual fields. All of our proved reserves are under production licenses granted by the PRC government.

At our request, Ryder Scott Company, an independent petroleum engineering consulting company, evaluated our selected properties as of December 31, 2003, 2004 and 2005. For further information regarding our reserves, see "Item 3--Key Information--Risk Factors--Risks relating to our business--The oil and gas reserves data in this annual report may require substantial revisions as a result of future drilling, testing and production."

The following tables set forth net proved crude oil reserves, net proved natural gas reserves and total net proved reserves, as of the dates indicated, for our independent and production sharing contract operations in each of our operating areas.

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Total Net Proved Crude Oil Reserves
(mmbbls)

	As of December 31,		As of Decem	
	2003	2004	Developed	Unde
Offshore China				
Independent				
Bohai Bay.........................	474.3	487.8	285.3	
Western South China Sea...........	135.2	147.6	43.2	
Eastern South China Sea...........	56.6	69.1	39.6	
East China Sea....................	4.6	21.5	2.8	
Total........................	670.8	726.0	370.9	
Production Sharing Contracts				
Bohai Bay.........................	516.1	486.8	166.7	
Western South China Sea...........	38.5	42.0	34.5	
Eastern South China Sea...........	98.1	98.8	72.4	
East China Sea....................	9.3	--	--	
Total........................	662.0	627.6	273.6	
Combined				
Bohai Bay.........................	990.4	974.6	452.0	
Western South China Sea...........	173.7	189.7	77.6	
Eastern South China Sea...........	154.8	168.0	112.0	
East China Sea....................	13.9	21.5	2.8	
Total........................	1,332.7	1,353.8	644.4	
Overseas(1)				
Indonesia.........................	103.4	101.9	62.7	
North West Shelf, Australia........	--	--	14.4	

Total..............................	103.4	101.9	77.1	
Total...................................	1,436.1	1,455.6	721.5	
	=======	=======	=========	====

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(1) As of December 31, 2005, our net proved reserves attributable to overseas operations were derived mainly from Indonesia and Australia. We conduct our operations in Indonesia through production sharing contracts and technical assistance contracts. In Australia, we hold interests in the North West Shelf project.

Total Net Proved Natural Gas Reserves
(bcf)

	As of December 31,		As of Decem	
	2003	2004	Developed	Unde
Offshore China				
Independent				
Bohai Bay.........................	491.9	706.2	304.4	
Western South China Sea...........	2,049.3	2,009.7	1,329.4	
Eastern South China Sea...........	506.9	687.7	--	
East China Sea....................	48.7	403.4	60.0	
Total.......................	3,096.8	3,807.0	1,693.8	
Production Sharing Contracts				
Bohai Bay.........................	74.7	--	--	
Western South China Sea...........	514.7	475.1	404.1	
Eastern South China Sea...........	41.2	43.0	--	
East China Sea....................	226.7	--	--	
Total.......................	857.3	518.1	404.1	
Combined				
Bohai Bay	566.6	706.2	304.4	
Western South China Sea...........	2,564.0	2,484.8	1,733.5	
Eastern South China Sea...........	548.2	730.8	--	
East China Sea....................	275.3	403.4	60.0	
Total.......................	3,954.1	4,325.2	2,097.9	

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	As of December 31,		As of Decem	
	2003	2004	Developed	Unde
Overseas(1)				
Indonesia.........................	200.3	321.4	154.6	
North West Shelf, Australia.......	--	--	377.7	
Total.......................	200.3	321.4	532.3	
Total...................................	4,154.4	4,646.6	2,630.3	
	=======	=======	=========	====

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(1) As of December 31, 2005, our net proved reserves attributable to

overseas operations were derived mainly from Indonesia and Australia. We conduct our operations in Indonesia through production sharing contracts and technical assistance contracts. In Australia, we hold interests in the North West Shelf project.

Total Net Proved Reserves
(million BOE)

	As of December 31,		As of Decem	
	2003	2004	Developed	Unde
Offshore China				
Independent				
Bohai Bay	556.3	605.5	336.0	
Western South China Sea	476.7	482.6	264.7	
Eastern South China Sea	141.1	183.7	39.6	
East China Sea	12.7	88.7	12.8	
Total	1,186.9	1,360.5	653.1	
Production Sharing Contracts				
Bohai Bay	528.5	486.8	166.7	
Western South China Sea	124.3	121.2	101.8	
Eastern South China Sea	105.0	106.0	72.4	
East China Sea	47.1	--	--	
Total	804.9	714.0	340.9	
Combined				
Bohai Bay	1,084.8	1,092.3	502.7	
Western South China Sea	601.0	603.8	366.5	
Eastern South China Sea	246.1	289.8	112.0	
East China Sea	59.8	88.7	12.8	
Total	1,991.7	2,074.6	994.0	
Overseas(1)				
Indonesia	136.7	155.5	88.5	
North West Shelf, Australia	--	--	77.3	
Total	136.7	155.5	165.8	
Total	2,128.5	2,230.0	1,159.8	

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(1) As of December 31, 2005, our net proved reserves attributable to overseas operations were derived mainly from Indonesia and Australia. We conduct our operations in Indonesia through production sharing contracts and technical assistance contracts. In Australia, we hold interests in the North West Shelf project.

Oil and Natural Gas Production

The following tables show average daily net oil production, net natural gas production, and average net total production for the periods indicated. Oil production comprises crude oil, condensate and natural gas liquids.

Average Daily Net Production of Crude Oil

(bbls per day)

	Year ended December 31,		
	2003	2004	2005
Offshore China			
Independent			
Bohai Bay........................	98,790	94,769	118,605
Western South China Sea...........	27,547	26,737	24,913
Eastern South China Sea...........	13,708	19,497	20,047
East China Sea....................	2,536	2,121	1,706
Total.......................	142,581	143,123	165,271
Production Sharing Contracts			
Bohai Bay........................	30,716	39,744	60,235
Western South China Sea...........	33,397	29,136	24,103
Eastern South China Sea...........	59,273	77,492	83,694
East China Sea....................	-	-	-
Total.......................	123,386	146,372	168,032
Combined			
Bohai Bay........................	129,506	134,512	178,840
Western South China Sea...........	60,944	55,873	49,016
Eastern South China Sea...........	72,981	96,989	103,741
East China Sea....................	2,536	2,121	1,706
Total.......................	265,967	289,495	333,303
Overseas(1)			
Indonesia........................	40,497	29,941	23,565
Total.......................	40,497	29,941	23,565
Total..............................	306,464	319,436	356,868

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(1) As of December 31, 2005, our net production attributable to overseas operations were derived entirely from our operations in Indonesia. We conduct our operations in Indonesia through production sharing contracts and technical assistance contracts.

Average Daily Net Production of Natural Gas
(mmcf per day)

	Year ended December 31,		
	2003	2004	2005
Offshore China			
Independent			
Bohai Bay........................	47.1	47.7	49.1
Western South China Sea...........	29.1	83.7	99.4
Eastern South China Sea...........	-	-	-
East China Sea....................	14.2	17.1	18.3
Total.......................	90.4	148.5	166.8
Production Sharing Contracts			
Bohai Bay........................	-	-	-
Western South China Sea...........	98.7	131.6	130.1
Eastern South China Sea...........	-	-	-
East China Sea....................	-	-	-
Total.......................	98.7	131.6	130.1
Combined			

Bohai Bay	47.1	47.7	49.1
Western South China Sea	127.8	215.2	229.6
Eastern South China Sea	-	-	-
East China Sea	14.2	17.1	18.3
Total	189.1	280.0	296.9
Overseas(1)			
Indonesia	101.9	84.1	92.7
Total	101.9	84.1	92.7
Total	291.0	364.1	389.6

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(1) As of December 31, 2005, our net production attributable to overseas operations were derived entirely from our operations in Indonesia. We conduct our operations in Indonesia through production sharing contracts and technical assistance contracts.

Average Daily Net Production
(BOE per day)

	Year ended December 31,		
	2003	2004	2005
Offshore China			
Independent			
Bohai Bay	106,637	102,725	126,786
Western South China Sea	32,391	40,683	41,486
Eastern South China Sea	13,708	19,497	20,047
East China Sea	4,908	4,963	4,751
Total	157,644	167,868	193,069
Production Sharing Contracts			
Bohai Bay	30,716	39,744	60,235
Western South China Sea	51,619	53,454	48,097
Eastern South China Sea	59,274	77,492	83,694
East China Sea	-	-	-
Total	141,609	170,690	192,026
Combined			
Bohai Bay	137,353	142,469	187,020
Western South China Sea	84,010	94,137	89,583
Eastern South China Sea	72,981	96,989	103,741
East China Sea	4,908	4,963	4,751
Total	299,252	338,558	385,095
Overseas(1)			
Indonesia	57,477	43,955	39,013
Total	57,477	43,955	39,013
Total	356,729	382,513	424,108

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(1) As of December 31, 2005, our net production attributable to overseas

operations were derived entirely from our operations in Indonesia. We conduct our operations in Indonesia through production sharing contracts and technical assistance contracts.

Principal Oil and Gas Regions

Bohai Bay

The Bohai Bay holds our largest net proved reserves and, for the year ended December 31, 2005, was our largest producing area for crude oil and natural gas. The Bohai Bay exploration area is located in the northeastern part of China, approximately 200 kilometers east of Beijing and is approximately 58,100 square kilometers in size. As of December 31, 2005, we had rights to operate, independently or in conjunction with international oil and gas companies, in 15 blocks covering approximately 43,244 square kilometers of the total Bohai Bay exploration area. Our operating area contains oil and gas fields in shallow waters with typical depths ranging from 10 to 30 meters. The crude oil is generally of heavy gravity ranging from 15 to 20 degrees API. As of December 31, 2005, net proved reserves in this region were 920.2 million barrels of crude oil and condensate and 740.7 billion cubic feet of natural gas, totaling 1,043.7 million BOE and representing approximately 44.2% of our total net proved reserves.

The Bohai Bay has been a prolific area with significant oil discoveries in recent years and will continue to be one of our principal areas for exploration in the near future. In 2005, we independently drilled in this area 11 wildcat wells, six of which were successful, and four appraisal wells, two of which were successful. In 2005, our foreign partners drilled in this area four wildcat wells, three of which were successful, and three appraisal wells, one of which was successful. We and our foreign partners made six and three discoveries, respectively, in this area in 2005.

The following table sets forth principal exploration blocks under exploration licenses for both our independent operations and our production sharing contracts in the Bohai Bay as of December 31, 2005. All exploration licenses expiring on or before June 6, 2006 are being renewed.

Blocks	Block Area (km(2))	Exploration License (Commencement-Expiration)
Middle of Bohai Bay	4,974	04/26/04~04/26/06
Southern Bohai Bay	3,679	06/08/04~06/08/06
Western Bohai Bay	1,895	06/08/04~06/08/06
Western Liaodong Bay	3,344	03/31/00~04/08/06
Eastern Liaodong Bay	2,829	07/02/01~07/02/06
Eastern Bozhong	1,861	05/30/04~05/30/06
Bohai Block 09/11	843	04/05/04~04/05/06
Bohai Block 06/17	2,586	02/20/03~02/20/07
Bohai Block 02/31	4,990	05/29/03~05/29/07
Bohai Block 11/19	3,068	06/08/04~06/08/06
Bohai Block 05/36	2,721	04/07/05~02/10/07
Eastern Bohai Block 11/05	3,601	02/10/04~02/10/06
Western Bohai Block 11/05	2,897	02/01/04~02/01/06
Bohai Block 09/18	2,234	02/04/05~02/04/07
Bohai Block 04/36	1,691	09/23/05~09/23/07

Total	43,213

During the year ended December 31, 2005, we independently acquired 2,770 kilometers of 2D seismic data and 775 square kilometers of 3D seismic data and our foreign partners acquired 21 square kilometers of 3D seismic data in the Bohai Bay. We have an aggregate of approximately 181,663 kilometers and 10,530 square kilometers of independent 2D and 3D seismic data, respectively, in the Bohai Bay. We also have access through our production sharing contract partners to approximately 66,903 kilometers and 9,177 square kilometers of additional 2D and 3D seismic data, respectively, in this area. Our exploration capital expenditures for 2005 were US$84.3 million. In 2006, we plan to drill 24 exploration wells in the Bohai Bay.

For 2005, net production in this region averaged 178,840 barrels per day of crude oil, condensate and natural gas liquids and 49.1 million cubic feet per day of natural gas, representing approximately 44.1% of our total daily net production. Our development capital expenditures for the Bohai Bay for 2005 were US$856.4 million.

The following table sets forth our principal oil and gas properties under production in the Bohai Bay as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Our Interest	Aver Pro for ye (BOE p
Liaoxi	Jinzhou20-2, Jinzhou9-3, Suizhong36-1, Luda4-2, Luda5-2, Luda10-1	100%	
09/18	Chengbei	100%	
Boxi	Qikou18-1, Qikou18-2, Qikou17-2, Qikou17-3	100%	
05/36	Nanbao35-2	100%	
	Qinghuangdao32-6	75.5%	
11/05	Penglai19-3	51%	
Bonan	Bozhong34-2, Bozhong34-4, Bozhong28-1, Bozhong26-2,	100%	

Name of Block	Major Oil and Gas Field	Our Interest	Aver Pro for ye (BOE p
	Bozhong25-1/25-1S	83.8%	
04/36	Caofeidian11-1, Caofeidian11-2,	51%	

Caofeidian11-3, Caofeidian11-5

The following table sets forth our principal oil and gas properties under development in the Bohai Bay as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Our Interest	Reserves December 3 (milli
Liaoxi	Jinzhou21-1, Jinzhou25-1S	100%	
Bozhong	Qinhuangdao33-1, Bozhong3-1, Bozhong3-2	100%	
Boxi	Caofeidian18-1, Caofeidian18-2, Qikou18-9, Bozhong13-1	100%	
11/05	Penglai25-6	51%	
04/36&05/36	Caofeidian12-1, Caofeidian12-1S	51%	
Bonan	Bozhong34-1, Bozhong34-1S, Bozhong34-3, Bozhong34-5	100%	
Liaodong	Luda27-2, Luda32-2	100%	
11/19	Bozhong19-4, Bozhong26-2N	100%	

Western South China Sea

The Western South China Sea has been our most important natural gas producing area. The Western South China Sea is located in the southern part of China southwest of Hong Kong and is approximately 712,480 square kilometers in size. As of December 31, 2005, we had rights to operate, independently or in conjunction with international oil and gas companies, in 34 blocks covering approximately 180,507 square kilometers of the Western South China Sea exploration area. Typical water depths in this region range from 40 meters to 120 meters. The crude oil produced is of medium to light gravity, ranging from 27 to 41 degrees API. As of December 31, 2005, we had net proved reserves of 205.7 million barrels of crude oil and condensate and 2,603.9 billion cubic feet of natural gas in this region, totaling 639.7 million BOE and representing 27.1% of our total net proved reserves.

The Western South China Sea is one of our least explored areas but will become increasingly important as the markets for natural gas in the southern part of China develop. In 2005, we independently drilled in this area six wildcat wells, three of which were successful, and three appraisal wells, three of which were successful. In 2005, our foreign partners drilled in this area four wildcat wells, one of which was successful. We and our foreign partners made three discoveries and one discovery, respectively, in this area in 2005.

The following table sets forth the principal exploration blocks under exploration licenses for both our independent operations and our production sharing contracts in the Western South China Sea as of December 31, 2005. Licenses expire on or before June 6, 2006 are being renewed.

Blocks	Block Area (km2)	Exploration License (Commencement-Expiration)
Weizhou 12 (Beibu Gulf)	6,980	05/11/01~05/11/06
Yulin 35 (Beibu Gulf)	6,050	05/11/01~05/11/06
Weizhou 26 (Beibu Gulf)	4,358	11/05/03~05/11/06
Ledong 01 (Yinggehai)	6,543	12/03/03~12/03/05
Lingtou 20 (Yinggehai)	2,692	08/30/00~08/30/07
Lingao 11 (Yinggehai)	4,117	05/11/01~05/11/06
Songtao 22 (Qiongdongnan)	4,063	05/11/01~05/11/06
Songtao 31 (Qiongdongnan)	5,264	05/11/01~05/11/06
Lingshui 18 (Qiongdongnan)	7,738	08/06/02~08/06/07
Yangjiang 31 (Pearl River Mouth Basin)	6,003	12/03/03~12/03/05
Qionghai 28 (Pearl River Mouth Basin)	5,208	05/11/01~05/11/06
Wenchang 11 (Pearl River Mouth Basin)	4,901	05/11/01~05/11/06
North Wanan-21 A	6,801	09/30/05~09/30/07
North Wanan-21 B	6,118	09/30/05~09/30/07
North Wanan-21 C	6,372	09/30/05~09/30/07
North Wanan-21 D	6,126	09/30/05~09/30/07
Total	89,334	

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During the year ended December 31, 2005, we independently acquired 5,664 kilometers of 2D seismic data and 787 square kilometers of 3D seismic data and our foreign partners acquired 186,504 kilometers of 2D seismic data and 8,844 square kilometers of 3D seismic data in the Western South China Sea. We have an aggregate of approximately 186,504 kilometers and 8,844 square kilometers of independent 2D and 3D seismic data, respectively, in the Western South China Sea. We also have access through our production sharing contract partners to approximately 106,907 kilometers and 4,656 square kilometers of additional 2D and 3D seismic data, respectively, in this area. Our exploration capital expenditures for the Western South China Sea for 2005 were US$76.0 million. In 2006, we plan to drill 18 exploration wells in the Western South China Sea area.

For 2005, net production in this region averaged 49,016 barrels per day of crude oil, condensate and natural gas liquids and 229.6 million cubic feet per day of natural gas, representing approximately 21.1% of our total daily net production. Our development capital expenditures for the Western South China Sea for 2005 were US$161.3 million.

The following table sets forth our principal oil and gas properties under production in the Western South China Sea area as of December 31, 2005.

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for y

Name of Block	Major Oil and Gas Field	Our Interest	(BOE
Yulin35	Weizhou Oil Field	100%	
Yangjiang31	Wenchang13-1, Wenchang13-2	60%	
Ledong01	Yacheng13-1	51%	
Changjiang25	Dongfang1-1	100%	

The following table sets forth our principal oil and gas properties under development in the Western South China Sea area as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Our Interest
Yangjiang31/32	Wenchang8-3, Wenchang14-3, Wenchang15-1, Wenchang19-1, Wenchang9-2, Wenchang9-3, Wenchang10-3	100%
Ledong01	Yacheng13-4, Ledong22-1, Ledong15-1	100%
Yulin35	Weizhou6-1, Weizhou11-1, Weizhou11-1N, Weizhou11-4N, Weizhou6-10,	100%
	Weizhou12-8	51%

Eastern South China Sea

The Eastern South China Sea is currently one of our most important oil producing areas in terms of its contribution to our total production and sales. The Eastern South China Sea exploration area is located in the southern part of China, directly southeast of Hong Kong, and is approximately 174,420 square kilometers in size. As of December 31, 2005, we had rights to operate, independently or in conjunction with international oil and gas companies, in 38 blocks covering approximately 193,704 square kilometers in the Eastern South China Sea exploration area. This area includes the important Pearl River Mouth Basin. Typical water depths in this region range from 100 meters to 120 meters. The crude oil produced is of medium to light gravity, ranging from 30 to 40 degrees API. As of December 31, 2005, we had net proved reserves of 211.2 million barrels of crude oil and condensate and 784.2 billion cubic feet of natural gas in this region, totaling 341.9 million BOE and representing approximately 14.5% of our total net proved reserves.

In 2005, we independently drilled in this area six wildcat wells, all of which were unsuccessful, and one appraisal well, which was successful. In

2005, our foreign partners drilled in this area four wildcat wells, one of which was successful, and one appraisal wells, which was successful. Our foreign partners made one discovery in this area in 2005.

The following table sets forth the principal exploration blocks under exploration licenses for both our independent operations and our production sharing contracts in the Eastern South China Sea as of December 31, 2005. All exploration licenses expiring on or before June 6, 2006 are being renewed.

Blocks	Block Area (km(2)	Exploration License (Commencement-Expiration)
Xijiang 04 (Pearl River Mouth Basin)	7,969	05/11/01~05/11/06
Xijiang 33 (Pearl River Mouth Basin)	4,983	05/12/05~05/12/07
Lufeng 06 (Pearl River Mouth Basin)	4,457	05/11/01~05/11/06
Huizhou 31 (Pearl River Mouth Basin)	3,074	05/11/01~05/11/06
Enping 15 (Pearl River Mouth Basin)	5,833	05/11/01~05/11/06
Enping 10 (Pearl River Mouth Basin)	6,547	05/11/01~05/11/06
Panyu 33 (Pearl River Mouth Basin)	4,830	05/11/01~05/11/06
Liuhua 07 (Pearl River Mouth Basin)	4,172	05/11/01~05/11/06
Dongsha 04 (Pearl River Mouth Basin)	5,295	05/11/01~05/11/06
Kaiping 14 (Pearl River Mouth Basin)	7,753	05/11/01~05/11/06
Kaiping 32 (Pearl River Mouth Basin)	8,104	05/11/01~05/11/06
Dongsha 32(Pearl River Mouth Basin)	7,350	11/05/03~11/05/10
Liwan 14 (Pearl River Mouth Basin)	7,752	05/11/01~05/11/06
Zijin 27 (Pearl River Mouth Basin)	5,396	05/11/01~05/11/06
15/20 (Pearl River Mouth Basin)	1,895	05/11/00~10/16/06
16/02 (Pearl River Mouth Basin)	3,495	03/31/01~03/31/07
Baiyun 15 (Pearl River Mouth Basin)	6,463	05/11/01~05/11/06
Huizhou 30 (Pearl River Mouth Basin)	5,862	05/11/01~05/11/06
Lufeng 08 (Pearl River Mouth Basin)	4,684	06/06/05~06/06/07
16/05 (Pearl River Mouth Basin)	3,007	03/31/00~03/31/07
Total	108,921	

During the year ended December 31, 2005, we independently acquired 6,512 kilometers of 2D seismic data and 1,111 square kilometers of 3D seismic data and our foreign partners acquired 3,153 kilometers of 2D seismic data in the Eastern South China Sea area. We have an aggregate of approximately 72,817 kilometers and 3,769 square kilometers of independent 2D seismic data and 3D seismic data, respectively, in the Eastern South China Sea. We also have access through our production sharing contract partners to approximately 112,415 kilometers and 6,431 square kilometers of additional

2D and 3D seismic data, respectively, in this area. Our exploration capital expenditures for the Eastern South China Sea for 2005 were US$52.9 million. We plan to drill 3 exploration wells in the Eastern South China Sea in 2006.

For 2005, net production in this region averaged approximately 103,741 barrels per day of crude oil, condensate and natural gas liquids, representing approximately 24.5% of our total daily net production. Our development capital expenditures for this region for 2005 were US$554.1 million.

The following table sets forth our principal oil and gas properties under production in the Eastern South China Sea as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Our Interest	Ave Pr for y (BOE
Huizhou14	Huizhou Oil Fields	51%	
16/19	Huzhou19-3, Huizhou19-2, Huizhou19-1	51%	
15/12	Xijiang24-3	51%	
Xijiang24	Xijiang30-2	40%	
Huizhou31	Liuhua11-1	100%	
16/05	Lufeng13-1	25%	
	Lufeng13-2	100%	
Lufeng08	Lufeng22-1	25%	
15/34	Panyu4-2, Panyu5-1	51%	

The following table sets forth our principal oil and gas properties under development in the Eastern South China Sea as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Our Interest	Net Reserves as of December 31, 2005 (million BOE)
Liuhua07	Panyu30-1, Liuhua19-5	100%	96.7
Panyu33	Panyu34-1	100%	30.7
Xijiang04	Xijiang23-1	100%	47.2
15/34	Panyu11-6	51%	2.6
Huizhou14	Huizhou21-1(G)	51%	9.1
Huizhou16	Huizhou25-1, Huizhou25-3	51%	6.1

East China Sea

The East China Sea is the least explored area of our four principal regions offshore China, and an area that we expect to become an important natural gas production base in the future. The East China Sea is approximately 339,580 square kilometers in size and is located east of Shanghai. As of December 31, 2005, we had rights to operate, independently or in conjunction with international oil and gas companies, in 47 blocks (excluding the Pinghu block) covering approximately 209,816 square kilometers of the total East China Sea. On August 19, 2003, CNOOC, Sinopec, Pecten Orient Company of the United States (a subsidiary company of Shell) and Unocal reached an agreement to explore, develop and market natural gas, oil and condensate in Xihu Trough, East China Sea. Under the agreement CNOOC owned 30% of the project and accordingly, we acquired a 30% working interest in the project from CNOOC. In September 2004, Pecten Orient and Unocal exited the project and as a result, our working interest in the Xihu Trough project was increased to 50%. The project comprises three exploration and two development contract areas of the Xihu Trough covering approximately 22,000 square kilometers. The first development under the contracts will be in the Chunxiao development area, which is expected to

come on stream in the first half of 2006. The total block area of the Xihu Trough is approximately 59,565 square kilometers. Typical water depths in this region are approximately 90 meters and the crude oil and condensate are of light gravity. As of December 31, 2005, our net proved reserves in the Xihu Trough were 18.1 million barrels of crude oil and condensate and 365.7 billion cubic feet of natural gas, totaling 79.1 million BOE and representing 3.7% of our total net proved reserves. We are the operator of the project.

In 2005, we and our foreign partners drilled no wells in this area.

The following table sets forth the principal exploration blocks under existing exploration licenses or pending exploration licenses for both our independent operations and our production sharing contracts in the East China Sea as of December 31, 2005. All exploration licenses expiring on or before June 6, 2006 are being renewed.

Blocks	Block Area (km2)	Exploration License (Commencement-Expiration)
North Yellow Sea	6,471	05/25/01~05/25/06
Northern Trough (Northern South Yellow Sea)	912	08/30/00~08/30/07
Xihu Hangzhou 26 (East China Sea)	3,642	03/31/03~03/31/07
Xihu Hangzhou 17 (East China Sea)	4,227	08/28/01~08/28/08
Xihu Huangyan 04 (East China Sea)	2,848	08/28/01~08/28/08
Xihu Zhenhai 01 (East China Sea)	1,536	08/28/01~08/28/08
Lishui 33 (East China Sea)	2,999	12/05/05~07/01/09
Wenzhou 21 (East China Sea)	1,437	12/05/05~07/01/07
East China Sea 25/34	7,017	12/05/05~12/05/07
Kunshan Block 02 (East China Sea)	2,628	05/11/01~05/11/06
Jinhua Block 12 (East China Sea)	6,931	05/11/01~05/11/06
Tiantai 32 (East China Sea)	5,400	07/17/01~07/17/06
Fuzhou Block 02 (East China Sea)	3,064	05/11/01~05/11/06
Taibei Block 27 (East China Sea)	7,379	07/09/01~07/09/06
Taoyuan 07 (East China Sea)	6,457	07/09/01~07/09/06
Jilong 25 (East China Sea)	5,692	07/09/01~07/09/06
Total	68,640	

During the year ended December 31, 2005, we independently acquired 940 square kilometers of 3D seismic data. We have an aggregate of approximately 115,990 kilometers and 1,317 square kilometers of independent 2D and 3D seismic data, respectively, in the East China Sea area. We also have access through our production sharing contract partners to approximately 48,255 kilometers and 475 square kilometers, respectively, of additional 2D and 3D seismic data in this area. Our exploration capital expenditures for the East China Sea for 2005 were US$6.3 million. We plan to drill one exploration well in this area in 2006.

For 2005, our net production in this region averaged 1,706 barrels per day of crude oil, condensate and natural gas liquids and 18.3 million cubic feet per day of natural gas, representing 1.1% of our total daily net production. Our development capital expenditures for the East China Sea for 2005 were US$105.0 million.

The following table sets forth the principal oil and gas properties under production or development in the East China Sea as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Our Interest	Average net production for year 2005 (BOE per day)	Re Decem (
Under Production				
Pinghu	Pinghu Gas Field	30%	4,751	
Under Development				
Xihu Trough	Canxue, Duanqiao, Chunxiao, Tianwaitian, Baoyunting, Wuyunting	50%	-	

Overseas Activity

In early 2003 and 2004, we acquired interests in the Tangguh LNG project located in Indonesia. The Tangguh LNG partners have signed contracts to provide liquefied natural gas to South Korea and North America. For further details of these interests, see "--Natural Gas Business--Overseas Activity."

In December 2004, we completed the North West Shelf Project acquisition. We acquired a 25% stake in the China LNG Joint Venture, a new joint venture established within the NWS Gas Project. Under the terms of the transaction, We also acquired approximately a 5.3% interest in certain production licences, retention leases and an exploration permit of the NWS Gas Project, and a right to participate in future exploration undertaken over and above the proven reserves. See "--Natural Gas Business--Overseas Activity."

In April 2002, our wholly owned subsidiary, CNOOC Southeast Asia Limited, acquired subsidiaries in Indonesia formerly owned by Repsol YPF, S.A. These Indonesian subsidiaries together hold a portfolio of interests in oil and gas production sharing and technical assistance contracts in areas located offshore and onshore Indonesia. The main businesses of the Indonesian subsidiaries are the exploration, development and production of oil and gas offshore and onshore Indonesia. Their main assets comprise a portfolio of interests in four production sharing contracts and a technical assistance contract in that region. We estimate that our net proved reserves of the assets in Indonesia as of December 31, 2005 were approximately 123.2 million

BOE.

The interests owned by the Indonesian subsidiaries comprise the following assets:

- South East Sumatra Production Sharing Contract. The Indonesian subsidiaries own a 65.5409% interest in the South East Sumatra production sharing contract. This contract area covers approximately 8,100 square kilometers located offshore Sumatra and is the largest of the assets held by the Indonesian subsidiaries. It is operated and majority-owned by us. It is also one of the largest offshore oil developments in Indonesia and has produced more than one billion barrels of oil in over 20 years of production. The concession expires in 2018.

- Offshore North West Java Production Sharing Contract. The Indonesian subsidiaries own a 36.7205% interest in the Offshore North West Java production sharing contract. This contract area covers approximately 13,800 square kilometers in the Southern Java Sea, offshore Jakarta and has produced more than one billion BOE in over 20 years of production. It is operated by a member of the BP group and currently produces crude oil and natural gas. Its natural gas is sold to the Indonesia State Electric Company and the Indonesia State Gas Utility Company. The concession expires in 2017.

- West Madura Production Sharing Contract and Poleng Technical Assistance Contract. These subsidiaries own a 25.0% interest in the West Madura production sharing contract and a 50.0% interest in the Poleng technical assistance contract. These contract areas are located offshore Java, near the island of Madura and the Java city of Surabaya and cover approximately 1,600 square kilometers combined. Kodeco Energy Company is the operator for the West Madura production sharing contract and Korea Development Company is the

operator for the Poleng technical assistance contract, each assisted by certain of the Indonesian subsidiaries. These contract areas currently produce crude oil and natural gas. Their natural gas is sold to the Indonesia State Electric Company. The West Madura production sharing contract expires in May 2011. The Poleng technical assistance contract expires in December 2013. Three new oil and gas discoveries were made in this area in 2003.

- Blora Production Sharing Contract. The Indonesian subsidiaries own a 16.7% interest in the Blora production sharing contract. This contract area lies entirely onshore Java and covers an area of approximately 4,800 square kilometers. There has been no production of crude oil or natural gas from this concession. The current operator is Coparex Blora. The concession expires in 2026.

The remaining interests in the above assets at the time of our acquisition were owned by independent third parties, including Lundin Petroleum, BP, Kodeco, Kalila Energy, BG Group, Pertamina, INPEX, Kanematsu, Nissho Iwai, Nisseki Mitsubishi, Paladin Resources, C. Itoh and Co. and Amerada Hess.

In addition to our Indonesian subsidiaries and the acquisition of interests in the Tangguh LNG project, we have a 39.51% participating interest in a production sharing contract in the Malacca Strait in Indonesia.

On May 3, 2004, we, through our wholly owned subsidiary CNOOC Morocco Limited, acquired from Vanco Energy Corporation an 11.25% interest in a petroleum agreement for Ras Tafelney offshore Morocco.

In 2004 and 2005, we, Golden Aaron Pte. Ltd. and China Global Construction Limited. formed a joint venture and entered into six production sharing contracts with Myanmar Oil and Gas Enterprise. We act as the operator under these production sharing contracts. In early 2005, through our wholly owned subsidiary CNOOC Canada Limited, we acquired a 16.69% interest in MEG Energy Corp. for a consideration of 150 million Canadian dollars.

In June 2005, we made an offer to merge with Unocal for US$67 per share, or a total consideration of approximately US$18.5 billion. However, in light of considerable uncertainties and risks associated with the political climate in the United States, we withdrew the offer on August 2, 2005.

In January 2006, we signed an agreement with South Atlantic Petroleum Limited to acquire a 45% working interest in an offshore oil-mining license "OML 130" in Nigeria for a cash consideration of US$2.268 billion. The acquisition was completed in April 2006. On January 27, 2006, CNOOC Africa Limited, a wholly-owned subsidiary of CNOOC International Ltd., signed an agreement of share sale and purchase deed with ARED Projects Nigeria Limited to acquired a 35% working interest in an offshore oil prospecting license "OPL 229" in Nigeria. CNOOC Africa Limited will pay US$ 60 million for the acquisition. In addition, we signed a production sharing contract for block S in Equatorial Guinea. Block S is an exploration block and covers a total area of approximately 2,287 square kilometers in the south offshore Equatorial Guinea.

On April 28, 2006, through our wholly-owned subsidiary CNOOC Africa Limited, we signed production sharing contracts (PSCs) for six blocks in Kenya. These six blocks, namely Block 1, Block 9, Block 10A, L2, L3, and L4 are located in the three basins of LAMU, ANZA and MANDERA. The total area is 115,343 square kilometers.

As of December 31, 2005, our net proved reserves in our overseas properties were 99.1 million barrels of crude oil and 899.9 billion cubic feet of natural gas. For 2005, net production from our overseas properties averaged 23,565 barrels per day of crude oil, condensate and natural gas liquids and 92.7 million cubic feet of natural gas, representing approximately 6.6% and 23.8%, respectively, of our total daily net production of crude oil and total daily net production of natural gas. Our interests in the production sharing contracts are held by our wholly owned subsidiaries.

We currently conduct all of our international oil sales through China Offshore Oil (Singapore) International Pte. Ltd., our wholly owned Singapore subsidiary. In the past, this subsidiary also engaged in oil trading activities.

The following table sets forth our principal overseas oil and gas properties under production or development as of December 31, 2005.

Name of Block	Major Oil and Gas Field	Average net production for year 2005 (BOE per day)	De
Under Production			
Indonesia	South East Sumatra, Offshore North West Java, West Madura, Poleng, and Malacca Strait	39,013	
Under Development			
Australia	North West Shelf	-	
Indonesia	Tangguh	-	

Other Oil and Gas Data

Production Cost Data

The following table sets forth average sales prices per barrel of crude oil, condensate and natural gas liquids sold, average sales prices per thousand cubic feet of natural gas sold and production costs per BOE produced for each of our independent, production sharing contract and combined operations for the periods indicated.

	Ye 20 (U
Average Sales Prices of Petroleum Produced	
Per Barrel of Crude Oil, Condensate and Natural Gas Liquids Sold........................	28
Per Thousand Cubic Feet of Natural Gas Sold...	2
Offshore China Average Lifting Costs per BOE Produced	
Independent..	4
Production Sharing Contracts..	4
Offshore China Average..	4
Overseas Average Lifting Costs per BOE Produced	
Net Entitlement...	9

Drilling and Productive Wells

The following table sets forth our exploratory and productive wells drilled offshore China as of December 31, 2005 by independent and production sharing contract operations in each of our operating areas. It includes exploratory and productive wells drilled offshore China prior to our inception in 1982.

	As of December 31, 20			
	Total	Bohai Bay	Western South China Sea	Eas S China
Independent				
Net Exploratory Wells	525	312	170	
Net Productive Wells	574.4	453	88	
Crude Oil	541.7	437	74	
Natural Gas	32.7	16	14	

Production Sharing Contracts				
Net Exploratory Wells	20.3	3.8	1.2	
Net Productive Wells*	965.4	229.9	20	
Crude Oil	918.5	229.9	14.4	
Natural Gas	46.9	-	5.6	
Totals				
Net Exploratory Wells	545.3	315.8	171.2	
Net Productive Wells	1539.8	682.9	108	1
Crude Oil	1460.2	666.9	88.4	1
Natural Gas	79.6	16	19.6	

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*Excluding abandoned wells.

Drilling Activity

The following tables set forth our net exploratory and development wells broken down by independent and production sharing contract operations in each of our operating areas for the years ended December 31, 2005, 2004 and 2003.

	Year ended December 31, 2005			
	Total	Bohai Bay	Western South China Sea	Eastern South China Sea
Independent				
Net Exploratory Wells Drilled	31	15	9	7
Successful	15	8	6	1
Dry	16	7	3	6
Net Development Wells Drilled	84	68	14	2
Successful	84	68	14	2
Dry	-	-	-	-
Production Sharing Contracts				

Net Exploratory Wells Drilled................	6.3	3.8	1.2	-
Successful................................	3.8	3.8	-	-
Dry.......................................	2.5	-	1.2	-
Net Development Wells Drilled................	54	42	-	4
Successful................................	54	42	-	4
Dry.......................................	-	-	-	-

	Year ended December 31, 2004			
	Total	Bohai Bay	Western South China Sea	Eastern South China Sea
Independent				
Net Exploratory Wells Drilled................	36	19	8	6
Successful................................	21	14	3	4
Dry.......................................	15	5	5	2
Net Development Wells Drilled................	42	34	4	2
Successful................................	42	34	4	2
Dry.......................................	-	-	-	-
Production Sharing Contracts				
Net Exploratory Wells Drilled................	4.6	-	-	-
Successful................................	3.3	-	-	-
Dry.......................................	1.3	-	-	-
Net Development Wells Drilled................	73	62	-	11
Successful................................	73	62	-	11
Dry.......................................	-	-	-	-

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	Year ended December 31, 200			
	Total	Bohai Bay	Western South China Sea	Eastern South China Sea
Independent				
Net Exploratory Wells Drilled................	28.0	16.0	5.0	7.0
Successful................................	14.0	6.0	3.0	5.0
Dry.......................................	14.0	10.0	2.0	2.0
Net Development Wells Drilled................	20.1	11.1	9.0	-
Successful................................	20.1	11.1	9.0	-
Dry.......................................	-	-	-	-
Production Sharing Contracts				
Net Exploratory Wells Drilled................	3.5	-	-	0.5
Successful................................	-	-	-	-
Dry.......................................	3.5	-	-	0.5
Net Development Wells Drilled................	78.0	42.9	-	3.1
Successful................................	72.0	42.9	-	3.1
Dry.......................................	6.0	-	-	-

Natural Gas Business

Natural gas is becoming an increasingly important part of our business strategy. We intend to exploit our natural gas reserves to meet rapidly growing demand in the PRC for natural gas. In light of increasing demand for natural gas in the PRC, we have made strategic investments in liquefied natural gas projects outside the PRC and may continue to do so in the future.

PRC Activity

CNOOC, our controlling shareholder, has granted us an option to invest in liquefied natural gas projects or other natural gas related businesses in which CNOOC has invested or proposed to invest. The terms of this option require us, if we exercise the option, to reimburse CNOOC for any contribution CNOOC has made with respect to the facility together with interest calculated at the prevailing market rate. CNOOC's major liquefied natural gas projects in the PRC include:

Guangdong LNG Facility. CNOOC is currently engaged in a project to build China's first proposed liquefied natural gas import facility in Guangdong Province in southern China. We have not entered into any negotiations with CNOOC on the detailed terms under which we may exercise our option to acquire CNOOC's interest in this facility. CNOOC has committed to take a 33% ownership interest in the project. Other partners include Hong Kong Electric Holding Company and Hong Kong & China Gas Company Limited, each committed to 3% ownership interests, and five customers of the proposed facility who have collectively committed to a 31% ownership interest. Through a competitive selection process, BP Global Investment Limited was selected as the foreign partner to take the remaining 30% interest in the project.

The project involves the construction of a receiving terminal with capacity of 3.7 million tonnes per year and a 380-kilometer trunk line. Project construction began in the third quarter of 2003. The facility is scheduled to commence operations in 2006.

Fujian Development. In October 2001, CNOOC signed an agreement with the Fujian provincial government on natural gas market development in Fujian Province. The agreement provides for a joint investment commitment to increase natural gas supply and gas market development in Fujian Province. Both parties are committed to sourcing gas, including liquefied natural gas, from all viable sources, including from offshore production and overseas. The parties also agreed to invest in gas-fired power plants and related infrastructure. The parties contemplate that the Tangguh LNG project in Indonesia will supply liquefied natural gas to this project. In August 2002, CNOOC announced that China's second LNG terminal would be built in Fujian by CNOOC and its partners. CNOOC owns a 60% interest in the

project. Construction for the project began in the third quarter of 2003. The project is scheduled to commence operations in 2008.

Zhejiang Development. In March 2004, CNOOC signed an agreement with Zhejiang provincial government to jointly develop China's third LNG terminal in Zhejiang. The joint development will include construction of an LNG re-gasification terminal, a gas trunk line and a gas-fired power plant. CNOOC will take a 51% interest in the project, with a Zhejiang government affiliate and a Ningbo city government affiliate taking a 29% interest and a 20% interest, respectively, in the project. Based on current plan and estimate, phase one construction of the project will be completed in 2008.

Shanghai LNG Project. In September 2004, CNOOC signed an agreement with a Shanghai municipal government affiliate to build a liquefied natural gas import facility in Shanghai. This project involves the construction of a receiving terminal and a submarine trunk line. Based on current arrangements, CNOOC will take a 45% equity interest in the project, with the Shanghai partner taking the remaining 55% interest. Based on current plan and estimate, phase one construction of the project will be completed in 2008.

Overseas Activity

On January 1, 2003, we acquired BP Muturi Limited, which owned a 44.0% interest in the Muturi production sharing contract offshore Indonesia, and BP Wiriagar Limited's 42.4% interest in the Wiriagar production sharing contract offshore Indonesia for a consideration of approximately US$275 million. The Muturi production sharing contract and Wiriagar production sharing contract, together with the Berau production sharing contract, make up the Tangguh LNG project. The Tangguh LNG project is a greenfield project located offshore Indonesia and is one of the largest natural gas projects in Asia. On May 12, 2004, we completed our acquisition of an additional 20.767% interest in the Muturi production sharing contract from British Gas International Limited for a consideration of US$105.1 million. As a result, our interest in the Muturi production sharing contract increased to 64.767%.

Our interests in these production sharing contracts represent 16.96% of the total reserves and upstream production of the Tangguh LNG project. The remaining interests in the Tangguh LNG project are held by BP Berau, BP Muturi, BP Wiriagar, MI Berau, Nippon, KG Berau, KG Wiriagar and Indonesia Natural Gas Resources Muturi. The partners in the Tangguh LNG project have applied to the Indonesia government to consolidate the three production sharing contracts and expect that BP will serve as the operator for the project.

In connection with our acquisition of interests in the Tangguh LNG project, the partners in the Tangguh LNG project entered into a conditional 25-year supply contract to provide up to 2.6 million tonnes of liquefied natural gas per year to a liquefied natural gas terminal project in Fujian Province, China. Supply of liquefied natural gas under this supply contract is expected to begin in 2009. In July 2004, the Tangguh PSC partners signed the LNG sales and purchases agreement("SPA") with POHANG Steel Co to provide up to 0.55 million tonnes per annum ("mtpa") LNG for 20 years. In August 2004, the Tangguh PSC partners signed the LNG SPA with K-Power. Co. Ltd. to provide up to 0.6 mtpa LNG for 20 years. In October 2004, the Tangguh PSC partners signed the LNG SPA with Sempra Energy LNG Marketing Corp. to provide up to 3.615 mtpa LNG for 20 years.

Given the proximity of the Tangguh LNG project to many major industrial and commercial areas, we expect the project to secure additional LNG supply contracts in the near future.

In May 2003, we signed an agreement with the original North West Shelf project partners to acquire an aggregate interest of 5.3% in the reserves and upstream production of Australia's North West Shelf project for a consideration of US$348 million. We completed this acquisition in December 2004. We booked 125.9 million BOE of gas reserves from this project in 2005. Woodside Petroleum is the operator for the project.

Pursuant to the agreement, we also acquired a 25% interest in the China LNG Joint Venture established by the six original partners to supply liquefied natural gas from the North West Shelf project to a liquefied natural gas terminal currently being developed by CNOOC, our controlling shareholder, and various partners in Guangdong Province, China. The terms of this transaction require us to pay the other partners in the North West Shelf project for gas production and processing services provided over the term of the China LNG Joint Venture. We are also required to make an upfront tariff payment of approximately US$180 million in relation to liquefied natural gas processing facilities. The partners of the project signed a 25-year LNG supply agreement in December 2004 to provide liquefied natural gas to the Guangdong liquefied natural gas terminal starting 2006.

On October 24, 2003, we entered into an agreement with the joint venture participants of the Gorgon natural gas project in Australia based on a memorandum of understanding, under which we agreed to acquire certain interest in the upstream production and reserves of the Gorgon natural gas project. The memorandum of understanding expired in March 2005.

In April, 2006, we signed Farm-in Agreements with BHP Billiton Limited and Kerr-McGee Australia Exploration and Production Pty Ltd through our subsidiary, CNOOC Australia E&P Pty Ltd, and obtained a 25% interest in four Exploration Permits in the Outer Browse Basin of Australia.

To the extent we invest in businesses and geographic areas where we have limited experience and expertise, we plan to structure our investments as alliances and partnerships with parties possessing the relevant experience and expertise.

Segment Information

The following table shows the breakdown of our total consolidated operating revenues for each of the periods indicated and the percentage contribution of each revenue component to our total operating revenues:

	Year ended December 31,			
	2003		2004	
	Rmb'000	%	Rmb'000	%
Independent operations..................	12,049,054	29.4	16,104,429	29.2
Production sharing contracts............	20,231,534	49.4	24,396,521	44.2
Trading businesses......................	12,398,661	30.3	18,191,353	32.9
Unallocated and elimination.............	(3,728,976)	(9.1)	(3,470,240)	(6.3)
Total operating revenues................	40,950,273	100.0	55,222,063	100.0

We are mainly engaged in the exploration, development and production of crude oil and natural gas primarily offshore China. For the year ended December 31, 2005, approximately 56.1% of our total revenue was contributed by PRC customers. Our overseas activities are mainly conducted in Indonesia, Australia, Myanmar and Nigeria.

Sales and Marketing

Sales of Offshore Crude Oil

We sell crude oil and natural gas to the PRC market through our wholly owned PRC subsidiary, CNOOC China Limited, and sell to the international market through our wholly owned subsidiary, China Offshore Oil (Singapore) International Pte. Ltd., located in Singapore.

We submit production and sales plans to the National Development and Reform Commission each year. Based on information provided by China's three crude oil producers, PetroChina, Sinopec and us, the National Development and Reform Commission compiles an overall national plan to coordinate sales. Our sales of crude oil to the international market also require us to obtain export licenses issued by the PRC Ministry of Commerce. Historically, we have been able to obtain all required export licenses.

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Pricing

We price our crude oil with reference to prices for crude oil of comparable quality in the international market, including a premium or discount mutually agreed upon by us and our customers according to market conditions at the time of the sale. Prices are quoted in U.S. dollars, but domestic sales are billed and paid in Renminbi. We currently produce three types of crude oil: Nanhai Light, Medium Grade and Heavy Crude. The table below sets forth the sales and marketing volumes, pricing benchmarks and average realized prices for each of these three types of crude oil for the periods indicated.

	Year ended December 31,		
	2003	2004	2005
Sales and Marketing Volumes (benchmark) (mmbbls)(1)			
Nanhai Light (APPI(2) Tapis(3))	20.4	13.1	18.4
Medium Grade (Daqing OSP(4))	69.6	91.8	85.3
Heavy Crude (APPI(2) Duri(5))	60.2	63.9	86.7
Average Realized Prices (US$/bbl)(6)			
Nanhai Light	US$30.27	US$41.24	US$54.52
Medium Grade	29.45	37.57	51.88
Heavy Crude	26.56	31.78	42.81
Benchmark Prices (US$/bbl)			
APPI(2) Tapis(3)	US$29.59	US$40.68	US$57.05
Daqing OSP(4)	28.94	36.55	52.56
APPI(2) Duri(5)	25.46	31.92	42.48
ICP Duri	27.11	32.09	46.01
ICP(7) Cinta	28.04	35.62	51.14
ICP Widuri	28.05	35.65	51.19
West Texas Intermediate (US$/bbl)	US$31.07	US$41.44	US$61.04

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(1) Includes the sales volumes of us and our foreign partners under production sharing contracts.
(2) Asia petroleum price index.
(3) Tapis is a light crude oil produced in Malaysia.

(4) Daqing official selling price. Daqing is a medium crude oil produced in northeast China.
(5) Duri is a heavy crude oil produced in Indonesia.
(6) Includes the average realized prices of us and our foreign partners under production sharing contracts.
(7) Indonesian crude price.

The international benchmark crude oil price, West Texas Intermediate, was US$61.13 per barrel as of December 30, 2005 and US$72.50 per barrel as of June 6, 2006.

Markets and Customers

We sell most of our crude oil production in the PRC domestic market. We also sell to customers in South Korea, Japan, the United States and Australia, as well as to crude oil traders in the spot market. For the years ended December 31, 2003, 2004 and 2005, we sold approximately 73.5%, 81.2% and 70.9%, respectively, of our crude oil in the PRC, and exported approximately 26.5%, 18.8% and 29.1%, respectively.

Most of our crude oil production sales in the PRC domestic market are to refineries and petrochemical companies that are affiliates of Sinopec, PetroChina and CNOOC, our controlling shareholder. Sales volume to Sinopec has been high historically because most of the PRC refineries and petrochemical companies were affiliates of Sinopec. After the restructuring of the PRC petroleum industry in July 1998, some refineries and petrochemical companies were transferred to PetroChina from Sinopec. For the years ended December 31, 2003, 2004 and 2005, sales to Sinopec were approximately

36.8%, 38.4% and 41.9%, respectively, and sales to PetroChina were approximately 7.7%, 7.0% and 5.0%, respectively, of our total crude oil sales in the PRC domestic market. Together these two customers accounted for approximately 44.5%, 45.4% and 46.9%, respectively, of our total crude oil sales in the PRC domestic market. For the same periods, sales to affiliates of CNOOC were approximately 43.9%, 41.2% and 48.0%, respectively, of our total crude oil sales in the PRC domestic market. For further information about our sales to CNOOC-affiliated companies, please see note 27 to our consolidated financial statements attached to this annual report.

The following table presents, for the periods indicated, our revenues sourced in the PRC and outside the PRC:

	Year ended December 31,		
	2003	2004	2005
	(Rmb in millions, except percentages)		
Revenues sourced in the PRC	25,416	30,453	38,993
Revenues sourced outside the PRC	15,534	24,769	30,463
Total revenues	40,950	55,222	69,456
% of revenues sourced outside the PRC	37.9%	44.9%	43.9%

Sales Contracts

We sign sales contracts with our oil customers for each shipment. Sales contracts are standard form contracts containing ordinary commercial terms such as quality, quantity, price, delivery and payment. All sales are made on free-on-board terms. Some of our customers are required to make payments within 30 days after the shipper takes possession of the crude oil cargo at our delivery points. Some of them are required to make prepayment or provide guarantee letters or letter of credit. As of December 31, 2003, 2004 and 2005, most of our account receivables were aged within six months. During the years ended December 31, 2003, 2004 and 2005, the accounts receivable turnover were approximately 47.5 days, 42.3 days and 32.6 days, respectively. Doubtful accounts provision during the years ended December 31, 2003, 2004 and 2005 were Rmb 1.5 million, nil and nil, respectively.

We have a credit control policy, including credit investigation of customers and periodic assessment of credit terms. Sales clerks are directly responsible for liaising with customers on the collection of receivables within the credit terms.

We price our crude oil in U.S. dollars. PRC customers are billed and make actual payments in Renminbi based on the exchange rate prevailing at the bill of lading date, while overseas customers are billed and are required to make payments in U.S. dollars within 30 days of the bill of lading date.

Sales of Natural Gas from Offshore China

Driven by environmental and efficiency concerns, the PRC government is increasingly encouraging residential and industrial use of natural gas to meet primary energy needs. In 1989, in order to encourage natural gas production, the PRC government adopted a favorable royalty treatment, which provides a royalty exemption for natural gas production up to two billion cubic meters (70.6 billion cubic feet or 11.8 million BOE) per year as compared to a royalty exemption available for crude oil production of up to one million tons or approximately seven million BOE per year. The favorable treatment also includes lower royalty rates on incremental increases in natural gas production as compared with the royalty rates for crude oil production.

Since 1989, the PRC government has adopted the following sliding scale of royalty payments of up to 3% of the annual gross production of natural gas:

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Annual gross production	Royalty rate
Less than 2 billion cubic meters................................	-
2-3.5 billion cubic meters......................................	1.0%
3.5-5 billion cubic meters......................................	2.0%
Above 5 billion cubic meters....................................	3.0%

We sell a large portion of our offshore China natural gas production to Hong Kong and Hainan Province. In December 1992, Castle Peak Power in Hong Kong signed a long-term gas supply contract under which it agreed to buy from the partners approximately 102.4 billion cubic feet of natural gas per year on a take-or-pay basis until 2015. Gas prices are quoted and paid in U.S. dollars. The payments are made in U.S. dollars on a monthly basis and are reconciled annually. Castle Peak Power purchased approximately 38.4% of our total offshore China natural gas production for the year ended December 31, 2005. We sold the remaining of our total offshore China natural gas production to mainland China customers, including Hainan Fertilizer, Hainan Yangpu Power, Shandong Yantai Zhongshi Gas and Hainan Refinery.

The price of gas sold to the PRC market is determined by negotiations between us and the buyers based on market conditions. Contracts typically consist of a base price with provisions for annual or seasonal resets and adjustment formulas which depend on a basket of crude oil prices, inflation and various other factors.

Procurement of Services

We usually outsource work in connection with the acquisition and processing of seismic data, reservoir studies, well drilling services, wire logging and perforating services and well control and completion service to independent third parties or our connected parties.

In the development stage, we normally employ independent third parties for single point mooring and floaring production storage and offloading, or FPSO, services and both independent third parties and CNOOC affiliates for other services by entering into contracts with them. We conduct a bidding process to determine who we employ to construct platforms, terminals and pipelines, to drill production wells and to install offshore production facilities. Both independent third parties and CNOOC affiliates participate in the bidding process. We are closely involved in the design and management of services by contractors and exercise extensive control over their performance, including their costs, schedule, quality and HSE (health, safety, and environment) measures.

Competition

Domestic Competition

The petroleum industry is highly competitive. We compete in the PRC and in international markets for customers as well as capital to finance our exploration, development and production activities. Our principal competitors in the PRC market are PetroChina and Sinopec.

We price our crude oil on the basis of comparable crude oil prices in the international market. The majority of our customers for crude oil are refineries affiliated with Sinopec and PetroChina to which we have been selling crude oil, from time to time, since 1982. Based on our dealings with these refineries, we believe that we have established a stable business relationship with them.

We are the dominant player in the oil and gas industry offshore China and are the only company permitted to engage in oil and gas exploration and production offshore China in cooperation with foreign parties. We may face increasing competition in the future from other petroleum companies in obtaining new PRC offshore oil and gas properties, or, as a result of changes in current PRC laws or regulations permitting an expansion of existing companies' activities or new entrants into the industry.

As part of our business strategy, we intend to expand our natural gas business to meet rapidly increasing domestic demand. Our competitors in the PRC natural gas market are PetroChina and, to a lesser extent, Sinopec. Our principal competitor, PetroChina, is the largest supplier of natural gas in China in terms of volume of natural gas supplied. PetroChina's natural gas business benefits from strong

market positions in Beijing, Tianjin, Hebei Province and northern China. We intend to develop related natural gas businesses in China's coastal provinces, where we may face competition from PetroChina and, to a lesser extent, Sinopec. We believe that our extensive natural gas resources base, the proximity of these resources to the markets in China, our relatively advanced technologies and our experienced management team will enable us to compete effectively in the domestic natural gas market.

Foreign Competition and the World Trade Organization

Imports of crude oil are subject to tariffs, import quotas, handling fees and other restrictions. The PRC government also restricts the availability of foreign exchange with which the imports must be purchased. The combination of tariffs, quotas and restrictions on foreign exchange has, to some extent, limited the competition from imported crude oil.

In line with the general progress of its economic reform programs, the PRC government has agreed to reduce import barriers as part of its WTO commitments. As a result of China joining the World Trade Organization as a full member on December 11, 2001, it is required to further reduce its import tariffs and other trade barriers over time, including with respect to certain categories of petroleum and crude oil. Notwithstanding China's WTO related concessions, crude and processed oil remain, for the time being, subject to restrictions on import rights and only certain designated state-owned enterprises may import crude and processed oil. Sinopec, PetroChina and several other domestic companies have received permission to import crude oil on their own. At present, foreign owned or foreign invested entities and other none-state-owned enterprises are subject to certain import quotas.

PRC Fiscal Regimes for Offshore Crude Oil and Natural Gas Activities

We conduct exploration and production operations either independently or jointly with foreign partners under our production sharing contracts. The PRC government has established different fiscal regimes for crude oil and natural gas production from our independent operations and from our production sharing contracts.

Royalties paid to the PRC government are based on our gross production from both independent operations and oil and gas fields under production sharing contracts. The amount of the royalties varies up to 12.5% based on the annual production of the relevant property. The PRC government has provided companies such as ours with a royalty exemption for up to approximately one million tons, or seven million BOE, per year for our crude oil production and for up to 70.6 billion cubic feet, or approximately 11.8 million BOE, per year for our natural gas production. The limits in these exemptions apply to our total production from both independent properties and properties under production sharing contracts. In addition, we pay production taxes to the PRC government equal to 5% of our crude oil and gas produced independently and 5% of our crude oil and gas produced under production sharing contracts.

Under our production sharing contracts, production of crude oil and gas is allocated among us, the foreign partners and the PRC government according to a formula contained in the contracts. Under this formula, a percentage of production under our production sharing contracts is allocated to the PRC government as its share oil. For more information about the allocation of production under the production sharing contracts, see "--Production Sharing Contracts--Offshore China--Production Sharing Formula."

We cannot give any assurance that the fiscal regime outlined above will not change significantly in the future.

Production Sharing Contracts

Offshore China

When exploration and production operations offshore China are conducted through a production sharing contract, the operator of the oil or gas field must submit a detailed evaluation report upon discovery of petroleum reserves. If such a discovery is determined commercially viable pursuant to the procedures set forth in the production sharing contract, an overall development plan must be submitted to

a joint management committee established under the production sharing contract for its review and adoption. After that, the overall development plan must also be submitted to CNOOC. After CNOOC confirms the overall development plan, CNOOC submits it to the National Development and Reform Commission for approval. After receiving the governmental approval, the parties to the production sharing contract may begin the commercial development of the oil and gas field.

As part of the reorganization in 1999, CNOOC transferred all of its economic interests and obligations under its then existing production sharing contracts to us and our subsidiaries. It also undertook to transfer its future production sharing contracts to us and our subsidiaries. As of December 31, 2005, we had 34 production sharing contracts.

Under PRC law, the negotiation of a production sharing contract is a function that only a state-owned national company, such as CNOOC, may perform. This function cannot be transferred to us because we are a pure commercial entity. Since the reorganization, under the terms of its undertaking with us, CNOOC, after entering into production sharing contracts with international oil and gas companies, is required to assign immediately to us all of its economic interests and obligations under the production sharing contracts. For further details, see "Item 4--Information on the Company--History and Development" and "Item 7--Major Shareholders and Related Party Transactions--Related Party Transactions."

New production sharing contracts are entered into between CNOOC and foreign partners primarily through bidding organized by CNOOC and direct negotiation.

Bidding Process

The bidding process typically involves the following steps:

- CNOOC, with the approvals of the PRC government, determines which blocks are open for bidding and prepares geological information packages and bidding documentation for these blocks;

- CNOOC invites foreign enterprises to bid;

- potential bidders are required to provide information, including estimates of minimum work commitments, exploration costs and percentage of share oil payable to the PRC government; and

- CNOOC evaluates each bid and negotiates a production sharing contract with the successful bidder.

Under CNOOC's undertaking with us, we may participate with CNOOC in all negotiations of new production sharing contracts.

The term of a production sharing contract typically lasts for 30 years and has three distinct phases:

- Exploration. The exploration period shall be divided into three phases with three, two and two years for each phase, and may be extended with the consent of CNOOC and the approval of relevant PRC regulatory authorities. During this period, exploratory and appraisal work on the exploration block is conducted in order to discover petroleum and to enable the parties to determine the commercial viability of any petroleum discovery.

- Development. The development period begins on the date on which the relevant PRC regulatory authorities approve the overall development plan, which outlines the recoverable reserves and schedule for developing the discovered petroleum reserves. The development phase ends when the design, construction, installation, drilling and related research work for the realization of petroleum production as provided in the overall development plan have been completed.

- Production. The production period begins when commercial production commences and usually lasts for 15 years. The production period may be extended upon approval of the PRC government.

Minimum Work Commitment

Under production sharing contracts that involve exploration activities, the foreign partners must complete a minimum amount of work during the exploration period, generally including:

- drilling a minimum number of exploration wells;

- producing a fixed amount of seismic data; and

- incurring a minimum amount of exploration expenditures.

Foreign partners are required to bear all exploration costs during the exploration period. However, such exploration costs can be recovered according to the production sharing formula after commercial discoveries are made and production begins. During the exploration period, foreign partners are required to return 25% of the contract area, excluding the development and production areas, to CNOOC at the end of each phase of the exploration period. At the end of the exploration period, all areas, excluding the development areas, production areas and areas under evaluation, must be returned to CNOOC.

Participating Interests

Pursuant to production sharing contracts, we have the right to take participating interests in any oil or gas field discovered in the contract area and may exercise this right after the foreign partners have made commercially viable discoveries. The foreign partners retain the remaining participating interests.

Production Sharing Formula

A chart illustrating the production sharing formula under our production sharing contracts is shown below.

Percentage of annual gross production	Allocation
5.0%	Production tax payable to the PRC government, or VAT(1)
0.0% -- 12.5%(2)	Royalty oil payable to the PRC government
50.0% -- 62.5%(2)	Cost recovery oil allocated according to the following priority: 1. recovery of current year operating costs by us and foreign partner(s); 2. recovery of earlier exploration costs by foreign partner(s); 3. recovery of development costs by us and foreign partner(s) based on participating interests;(3) and 4. any excess, allocated to the remainder oil.
32.5%(3)	Remainder oil allocated according to the following formula: 1. (1-X) multiplied by 32.5% represents share oil payable to the PRC government; and 2. X multiplied by 32.5% represents remainder oil distributed according to each partner's participating interest.(4)

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(1) The production tax is also referred to as "value-added tax" (VAT) in PRC production sharing contracts.
(2) Assumes annual gross production of more than four million metric tons, approximately 30 million barrels of oil. For lower amounts of production, the royalty rate will be lower and the cost recovery will be greater than 50.0% by the amount that the royalty rate is less than 12.5%.

(3) The ratio "X" is agreed in each production sharing contract based on commercial considerations and ranges from 8% to 100%.
(4) See "--Principal Oil and Gas Regions" for our participating interest percentage in our production sharing contracts.

The first 5.0% of the annual gross production is paid to the PRC government as production tax. The PRC government is also entitled to a royalty payment equal to the next 0% to 12.5% of the annual gross production based on the following sliding scale:

Annual gross production of oil(1)	Royalty rate
Less than 1 million tons...	0.0%
1-1.5 million tons...	4.0%
1.5-2.0 million tons...	6.0%

2.0-3.0 million tons	8.0%
3.0-4.0 million tons	10.0%
Above 4 million tons	12.5%

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(1) The sliding scale royalty for natural gas reaches a maximum at 3.0%.

Depending on the percentage of the PRC government's royalty payment, an amount equal to the next 50.0% to 62.5% of the annual gross production is allocated to the partners for cost recovery purposes. This amount is allocated according to the following priority schedule:

- recovery of operating costs incurred by the partners during the year;
- recovery of exploration costs, excluding interest accrued thereon, incurred but not yet recovered by foreign partners during the exploration period; and
- recovery of development investments incurred but not yet recovered, and interest accrued in the current year, according to each partner's participating interest.

The remaining 32.5% of the annual gross production, which is referred to as the remainder oil, is distributed to each of the PRC government, us and the foreign partners according to a "ratio X" agreed to by CNOOC and the foreign partners in the production sharing contracts. An amount of oil and gas equal to the product of the remainder oil and one minus the "ratio X" is first distributed to the PRC government as share oil. The balance of the remainder oil, which is referred to as the allocable remainder oil, is then distributed to us and the foreign partners based on each party's participating interest.

We pay production tax and royalty to the PRC government on a monthly basis for oil and natural gas production. At the end of each month, we calculate the production tax and royalty payable and file this information with the PRC tax bureau for current month payment. We make adjustments for any overpayment or underpayment of production tax and royalty at the end of the year.

The foreign partners have the right to either take possession of their allocable remainder oil for sale in the international market, or sell such crude oil to us for resale in the PRC market.

Management and Operator

Under each production sharing contract, a party will be designated as an operator to undertake the execution of the production sharing contract which includes:

- preparing work programs and budgets;
- procuring equipment and materials relating to operations;
- establishing insurance programs; and
- issuing cash-call notices to the parties to the production sharing contract to raise funds.

A joint management committee, which usually consists of six or eight persons, is set up under each production sharing contract to perform supervisory functions, and each of us and the foreign partners as a group has the right to appoint an equal number of representatives to form the joint management committee. The chairman of the joint management committee is the chief representative designated by us and the vice chairman is the chief representative designated by the foreign partners as a group. The joint management committee has the authority to make decisions on matters including:

- reviewing and approving operational and budgetary plans;
- determining the commercial viability of each petroleum discovery;
- reviewing and adopting the overall development plan; and
- approving significant procurements and expenditures, and insurance coverage.

Daily operations of a property subject to a production sharing contract are carried out by the designated operator. The operator is typically responsible for determining and executing operational and budgetary plans and all routine operational matters. Upon discovery of petroleum reserves, the operator is required to submit a detailed overall development plan to the joint management committee.

After the foreign partner has fully recovered its exploration and development costs under production sharing contracts in which the foreign partner is the operator, we have the exclusive right to take over the operation of the particular oil or gas field. With the consent of the foreign partner, we may also take over the operation before the foreign partner has fully recovered its exploration and development costs.

Ownership of Data and Assets

All data, records, samples, vouchers and other original information obtained by foreign partners in the process of exploring, developing and producing offshore petroleum become the property of CNOOC as a state-owned national oil company under PRC law. Through CNOOC, we have unlimited and unrestricted access to the data.

Our foreign partners and we have joint ownership in all of the assets purchased, installed or constructed under the production sharing contract until either:

- the foreign partners have fully recovered their development costs, or
- upon the expiration of the production sharing contract.

After that, as a state-owned national oil company under PRC law, CNOOC will assume ownership of all of the assets under the production sharing contracts; our foreign partners and we retain the exclusive right to use the assets during the production period.

Abandonment Costs

Any party to our production sharing contracts must give prior written notice to the other party or parties if it plans to abandon production of the oil or gas field within the contracted area. If the other party or parties agree to abandon production from the oil or gas field, all parties pay abandonment costs in proportion to their respective percentage of participating interests in the field. If we decide not to abandon production upon notice from a foreign partner, all of such foreign partner's rights and obligations under the production sharing contract in respect of the oil or gas field, including the responsibilities for payment of abandonment costs, terminate automatically. We bear the abandonment costs if we decide to abandon production after an initial decision to proceed with production. In 2005, we accrued for dismantlement costs of approximately Rmb 100 million for oil and gas fields governed by production sharing contracts.

Production Tax

The PRC production tax rate on the oil and natural gas produced under production sharing contracts is currently 5%.

Overseas

In addition to our production sharing arrangements in the PRC, we have made production sharing arrangements in several foreign countries and regions, including Indonesia, Australia, Morocco, Nigeria and Myanmar etc.

We have interests in production sharing contracts and a technical assistance contract in Indonesia. Indonesian oil and gas activities are currently supervised and controlled by BP MIGAS, the executive agency for upstream oil and gas activities in Indonesia. Under current Indonesian law, BP MIGAS is the sole entity authorized to manage Indonesia's oil and gas resources on behalf of the Indonesian government and to enter into agreements with foreign and domestic companies, functions previously conducted by Pertamina.

BP MIGAS enters into production sharing arrangements with private energy companies. The arrangements allow such private companies to explore and develop oil and gas in specified areas in exchange for a percentage interest in the production from such areas. These production sharing arrangements are mainly governed by production sharing contracts, as well as by technical assistance contracts, each of which is described further below. Upon entering into a production sharing arrangement, the operator commits to spending a specified sum of capital to implement an agreed work program.

Production sharing arrangements in Indonesia are based on the following principles:

- contractors are responsible for all investments (exploration, development and production);
- a contractor's investment and production costs are recovered from production;
- the profit split between the Indonesian government and contractors is based on production after the cost recovery, domestic market oil, etc;
- ownership of tangible assets remains with the Indonesian government; and
- overall control lies with BP MIGAS on behalf of the Indonesian government.

An original production sharing contract is awarded to explore for and to establish commercial hydrocarbon reserves in a specified area prior to commercial production. The contract is generally awarded for a number of years depending on the contract terms, subject to discovery of commercial quantities of oil and gas within a certain period. The term of the exploration period can generally be extended by agreement between the contractor and BP MIGAS. The contractor is generally required to relinquish specified percentages of the contract area by specified dates unless such designated areas correspond to the surface area of any field in which oil and gas has been discovered.

BP MIGAS is typically responsible for managing all production sharing contract operations, assuming and discharging the contractor from all taxes (other than Indonesian corporate taxes, taxes on interest, dividends and royalties and others as set forth in the production sharing contract), obtaining approvals and permits needed by the project and approving the contractor's work program and budget. The responsibilities of a contractor under a production sharing contract generally include advancing necessary funds, furnishing technical aid and preparing and executing the work program and budget. In return, the contractor may freely lift, dispose of and export its share of crude oil and retain the proceeds obtained from its share.

The contractor generally has the right to recover all finding and developing costs, as well as operating costs, in each production sharing contract against available revenues generated after deduction of first tranche production of oil and gas, or FTP. Under FTP terms, the parties are entitled to take and receive an annually agreed percentage of production from each production zone or formation each year,

prior to any deduction for recovery of operating costs, investment credits and handling of production. FTP for each year is generally shared between the Indonesian government and the contractor in accordance with the standard sharing splits. The balance is available for cost recovery. Post-cost recovery, the Indonesian government is entitled to a specified profit share of crude oil production and of natural gas production. Under each production sharing arrangement, the contractor is obligated to pay Indonesian corporate taxes on its specified profit share at the Indonesian corporate tax rate in effect at the time the agreement is executed.

Production sharing contracts in Indonesia have long included a provision known as the domestic market obligation, or DMO, under which a contractor must sell a specified percentage of its crude oil to the local market at a reduced price. After the first five years of a field's production, the contractor is required to supply, the lesser of (i) 25% of the contractor's before-tax share of total crude oil production or (ii) the contractor's share of profit oil. This reduced price varies from contract to contract and is calculated at the point of export.

The new Indonesian Oil and Gas Law, which came into force on November 23, 2001, stipulates a gas DMO, under which the contractor must sell up to 25% of its gas entitlement to the domestic market, although it is not clear at what price this gas must be sold. Production sharing contract parties have stated that they would prefer that this price be determined on the open market, and that it be recognized that if there are pre-existing gas sale agreements, or if the project produces LNG for export, the obligation to sell gas into the local market may not be feasible.

Technical assistance contracts are awarded when a field has prior or existing production. The oil or gas production is divided into non-shareable and shareable portions. The non-shareable portion represents the expected production from the field at the time the technical assistance contract is signed and is retained by Pertamina. The shareable portion represents the additional production resulting from the operator's investment in the field and is split in the same way as for an original production sharing contract as described above.

We also have interests in production sharing contracts in various countries, including Morocco, Nigeria and Myanmar. On May 3, 2004, we, through our wholly owned subsidiary CNOOC Morocco Limited, acquired from Vanco Energy Corporation an 11.25% interest in a petroleum agreement for Ras Tafelney offshore Morocco. In 2004 and 2005, we, Golden Aaron Pte. Ltd. and China Global Construction Limited formed a joint venture in Myanmar and had entered into six production sharing contracts as of June 8, 2005. In January 2006, we acquired a 35% working interest in the contract for OPL 229 in Nigeria. In April 2006, we acquired a 45% interest in offshore Nigerian oil mining license "OML 130".

On February 17, 2006, we signed a production sharing contract for block S in Equatorial Guinea. On April 28, 2006, through our wholly-owned subsidiary CNOOC Africa Limited, we signed production sharing contracts for six blocks in Kenya. We will act as the operator under these production sharing contracts.

Geophysical Survey Agreements

Historically, we conducted our exploration operations through geophysical survey agreements with leading international oil and gas companies through production sharing contracts. For the year ended December 31, 2005, we did not enter into any geophysical survey agreements with third parties, but may enter such agreements in the future.

Geophysical survey agreements are designed for foreign petroleum companies to conduct certain geophysical exploration before they decide whether to enter into production sharing contract negotiations with CNOOC. Geophysical survey agreements usually have a term of less than two years. International oil and gas companies must complete all of the work confirmed by both parties in the agreements and bear all the costs and expenses. If a foreign partner decides to enter into a production sharing contract with CNOOC, the costs and expenses that the foreign partner incurs in conducting geophysical survey may be recovered by the foreign partner in the production period subject to our confirmation. CNOOC

has the sole ownership of all data and information obtained by the foreign partner during the geophysical survey, and, through CNOOC, we have access to all such data.

Under PRC law, the negotiation of a geophysical survey agreement is a function that only a state-owned national company, such as CNOOC, can perform. As part of its reorganization in 1999, CNOOC transferred to us all its commercial rights under a geophysical survey agreement, which has since been completed. In the future, CNOOC has agreed to assign to us all of its commercial rights under any geophysical survey agreements it enters into with international oil and gas companies.

Operating Hazards and Uninsured Risks

Our operations are subject to hazards and risks inherent in the drilling, production and transportation of crude oil and natural gas, including pipeline ruptures and spills, fires, explosions, encountering formations with abnormal pressures, blowouts, cratering and natural disasters, any of which can result in loss of hydrocarbons, environmental pollution and other damage to our properties and the properties of operators under production sharing contracts. In addition, certain of our crude oil and natural gas operations are located in areas that are subject to tropical weather disturbances, some of which can be severe enough to cause substantial damage to facilities and interrupt production.

As protection against operating hazards, we maintain insurance coverage against some, but not all, potential losses, including the loss of wells, blowouts, pipeline leakage or other damage, certain costs of pollution control and physical damages on certain assets. Our insurance coverage includes oil and gas field properties and construction insurance, marine hull insurance, protection and indemnity insurance, drilling equipment insurance, marine cargo insurance and third party and comprehensive general liability insurance. We also carry business interruption insurance for Pinghu Field. In Indonesia, the operators of the production sharing contracts in which we participate are required by local law to purchase insurance policies customarily taken out by international petroleum companies. As of December 31, 2005, we paid an annual insurance premium of approximately Rmb 163.1 million to maintain our insurance coverage. We believe that our level of insurance is adequate and customary for the PRC petroleum industry and international practices. However, we may not have sufficient coverage for some of the risks we face, either because insurance is not available or because of high premium costs. See "Item 3--Key Information--Risk Factors--Risks relating to our business--Exploration, development and production risks and natural disasters affect our operations and could result in losses that are not covered by insurance."

For the year ended December 31, 2005, we did not have any uninsured losses.

Research and Development

Historically, we used research and development services provided by CNOOC's affiliates, including CNOOC Research Center, as well as other international research entities. In July 2003, we established our own research center, CNOOC (China) Limited Research Center, to undertake most of our research and development activities. During the years ended December 31, 2003, 2004 and 2005, our research and development costs were approximately Rmb 165.8 million, Rmb 268.5 million and Rmb 401.6 million, respectively.

Our research efforts have focused on:

- enhancing oil recovery in offshore China heavy oil fields;
- engineering and developing deepwater fields;
- engineering and developing marginal fields; and
- developing new offshore exploration technology and new exploration areas.

We are also studying various ways of utilizing our existing reserves including:

- building more accurate reservoir models;
- re-processing existing seismic and log data to locate potential areas near existing fields to be integrated into existing production facilities; and
- researching ways to reduce development risks for marginal fields and to group fields into joint developments to share common facilities.

For further information regarding our agreement with CNOOC Research Center, see "Item 7--Major Shareholders and Related Party Transactions--Related Party Transactions--Categories of Connected Transactions--Research and development services."

Regulatory Framework

Government Control

The PRC government owns all of China's petroleum resources and exercises regulatory control over petroleum exploration and production activities in China. We are required to obtain various governmental approvals, including those from the Ministry of Land and Resources, the State Administration for Environmental Protection, the National Development and Reform Commission and the Ministry of Commerce before we are permitted to conduct production activities. Our sales are coordinated by the National Development and Reform Commission. For joint exploration and production with foreign enterprises, we are required to obtain various governmental approvals, through CNOOC, including those from:

- the Ministry of Land and Resources, for a permit for exploration blocks, an approval of a geological reserve report submitted through CNOOC;
- the Ministry of Land and Resources or the National Development and Reform Commission to designate such blocks as an area for foreign cooperation;
- the Ministry of Commerce for the production sharing contracts between CNOOC and the foreign enterprises;
- the State Administration for Environmental Protection for an environmental impact report submitted through CNOOC;
- the National Development and Reform Commission for an overall development plan submitted through CNOOC; and
- the Ministry of Land and Resources, for an extraction permit.

Since the conclusion of the meeting of the National People's Congress in March 2003, the PRC government has undergone substantial reform. It is believed that market-oriented reforms will continue.

Special Policies Applicable to the Offshore Petroleum Industry in China

Since the early 1980s, the PRC government has adopted policies and measures to encourage the development of the offshore petroleum industry. These policies and measures, which were applicable to CNOOC's operations prior to the reorganization, became applicable to our operations in accordance with an undertaking agreement between us and CNOOC. As approved by the relevant PRC government authorities, including the Ministry of Land and Resources and the

Ministry of Commerce, these policies and measures have provided us with the following benefits:

- the exclusive right to explore for, develop and produce petroleum offshore China in cooperation with international oil and gas companies and to sell this petroleum in China;

- the flexibility to set our prices in accordance with international market prices and determine where to sell our crude oil, with only minimal supervision from the PRC government;

- a favorable 5% production tax on the crude oil and natural gas we produce both independently and under production sharing contracts, rather than the 17% rate generally applicable to the independent production of domestic petroleum companies in China; and

- production from one of our major gas fields, Yacheng 13-1, is exempt from the PRC royalties under an approval by the State Tax Bureau in May 1989 and the 5% production tax applicable to the oil and gas produced under other production sharing contracts in accordance with an approval by the Ministry of Finance in August 1985. Our natural gas revenues from Yacheng 13-1 for each of the five years ended December 31, 2001, 2002, 2003, 2004 and 2005 represented approximately 7.3%, 5.6%, 3.6%, 3.2% and 2.3%, respectively, of our total oil and natural gas sales in those years.

Although we historically have benefited from the foregoing special policies, we cannot assure that such policies will continue in the future. We are also regulated by the PRC government in various other aspects of our business and operations, including required government approvals for new independent development and production projects and new production sharing contracts. For a further discussion of ways in which we are regulated by the PRC government, see "--Government Control."

Policies Applicable to International Oil and Gas Companies Operating Offshore China

The PRC government encourages foreign participation in offshore petroleum exploration and production through exclusive cooperation with CNOOC. In 1982, the State Council promulgated the Regulation of the People's Republic of China on Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises, which grants to CNOOC the exclusive right to enter into joint cooperation arrangements with foreign enterprises for offshore petroleum exploration and production. From 1982 to 2000, CNOOC successfully completed several rounds of bidding for offshore petroleum exploration and production projects, and many international oil and gas companies have been involved and awarded exploration blocks for joint exploration, development and production with CNOOC.

In October 2001, the State Council amended the regulation referred to above as a part of the comprehensive review of all business laws and regulations by the Chinese government to ensure their compliance with its WTO commitments. The amendment revised such terms in the law governing offshore exploration as restrictive provisions on technology transfers and domestic components requirements in procurement. The removal of these restrictions will provide a level playing field for all oilfield service contractors, domestic or international. These amendments are expected to benefit CNOOC's businesses as well as our exploration and production business and further increase production sharing contract activities offshore China. CNOOC will continue to enjoy the exclusive right to conduct production sharing contract activities with foreign contractors and is entitled to all rights and privileges under the previous regulation. The regulation also states that CNOOC, as a state-owned enterprise, is to be in charge of all efforts to exploit petroleum resources with contractors in Chinese waters. Currently, international oil and gas companies can only undertake offshore petroleum exploration and production activities in China after they have entered into a production sharing contract with CNOOC.

In March 2006, the State Council issued the Decision to Impose a Levy on Special Oil Income and the Ministry of Finance promulgated the Management Rules on the Administration of Special Oil Income Levy, effective March 26, 2006. According to the rules, the Ministry of Finance will impose a special oil income levy on any income derived from the sales by an oil exploration and production company of locally produced crude oil at a price which exceeds US$40 per barrel. The special oil income levy will be collected on a quarterly basis. As the international oil prices, exchange rate of Renminbi and our crude oil production fluctuate, the full impact on us as a result of the implementation of the Special oil income levy cannot be ascertained at this time.

Environmental Regulation

Our operations are required to comply with various applicable environmental laws and regulations, including PRC laws and regulations administered by the central and local government environmental protection bureaus for our operations in China. We are also subject to the environmental rules introduced by governments in whose jurisdictions our onshore logistical support facilities are located. The State Administration for Environmental Protection sets national environmental protection standards and local environmental protection bureaus may set stricter local standards.

The relevant environment protection bureau must approve or review each stage of a project. We must file an environmental impact statement or, in some cases, an environmental impact assessment outline before an approval can be issued. The filing must demonstrate that the project conforms to applicable environmental standards. The relevant environmental protection bureau generally issues approvals and permits for projects using modern pollution control measurement technology.

The PRC national and local environmental laws and regulations impose fees for the discharge of waste substances above prescribed levels, require the payment of fines for serious violations and provide that the PRC national and local governments may at their own discretion close or suspend any facility which fails to comply with orders requiring it to cease or cure operations causing environmental damage.

For the year ended December 31, 2005, we did not experience any major incident of oil spillage.

The PRC environmental laws require offshore petroleum developers to pay abandonment costs. Our financial statements include provisions for costs associated with the dismantlement of oil and gas fields during the years ended December 31, 2003, 2004 and 2005 of approximately Rmb 167.3 million, Rmb 201.6

million and Rmb 252.9 million, respectively.

Environmental protection and prevention costs and expenses in connection with the operation of offshore petroleum exploitation are covered under each individual production sharing contract. Environmental protection and prevention costs and expenses represented on average approximately 4% of our annual operating costs relating to projects constructed offshore China during the three years ended December 31, 2005. Each platform has its own environmental protection and safety staff responsible for monitoring and operating the environmental protection equipment. However, no assurance can be given that the PRC government will not impose new or stricter regulations which would require additional environmental protection expenditures.

We are not currently involved in any environmental claims and believe that our environmental protection systems and facilities are adequate for us to comply with applicable national and local environmental protection regulations.

Legal Proceedings

We are not a defendant in any material litigation, claim or arbitration, and know of no pending or threatened proceeding which would have a material adverse effect on our financial condition.

Patents and Trademarks

We own or have licenses to use two trademarks which are of value in the conduct of our business. CNOOC is the owner of the "CNOOC" trademark. Under two non-exclusive license agreements between CNOOC and us, we have obtained the right to use this trademark for a nominal consideration.

Real Properties

Our corporate headquarters is located in Hong Kong. We also lease several other properties from CNOOC in China and Singapore. The rental payments under these lease agreements are determined with

reference to market rates. For further details regarding the terms of these leases, see "Item 7--Major Shareholders and Related Party Transactions--Related Party Transactions--Categories of Connected Transactions--Lease agreement in respect of the Nanshan Terminal," and "--Lease and property management services."

We own the following main property interests in the PRC:

o land, various buildings and structures at Xingcheng JZ 20-2 Natural Gas Separating Plant, Dongyao Village, Shuangsu Township, Xingcheng City, Liaoning Province;

o land, various buildings and structures located at Boxi Processing Plant, South of Jintang Subway, Tanggu District, Tianjin City;

o land, various buildings and structures at Weizhou Terminal Processing Plant, Weizhou Island, Weizhou Town, Beihai City, Guangxi Zhuang Autonomous Region;

o a parcel of land at Suizhong 36-1 Base, Xiaolihuang Village, Gaoling Town, Suizhong County, Liaoning Province;

- land, various buildings and structures located at Bonan Processing Plant, Jimu Island, Longgang Development Zone, Longkou City, Shandong Province;

- land, various buildings and structures located at Dongfang 1-1 Processing Plant, Shugang Road, Dongfang City, Hainan Province;

- 50% interest in land, various buildings and structures located at Panyu-Huizhou Gas Processing Plant, Huandao North Road, Hengqin Town, Zhuhai City, Guangdong Province; and

- land, various buildings and structures located at Chunxiao Gas Processing Plant, Chunxiao Road, Chunxiao Town, Beilun District, Ningbo City, Zhejiang Province.

Employees and Employee Benefits

During the years ended December 31, 2003, 2004 and 2005, we employed 2,447 persons, 2,524 persons and 2,696 persons, respectively. Of the 2,696 employees we employed as of December 31, 2005, approximately 72.4% were involved in petroleum exploration, development and production activities, approximately 7.1% were involved in accounts and finance work and the remainder were senior management, coordinators of production sharing contracts and safety and environmental supervisors. Workers for the operation of the oil and gas fields, maintenance personnel and ancillary service workers are hired on a contract basis.

We have a trade union that:

- protects employees' rights;

- organizes educational programs;

- assists in the fulfillment of economic objectives;

- encourages employee participation in management decisions; and

- assists in mediating disputes between us and individual employees.

We have not been subjected to any strikes or other labor disturbances and believe that relations with our employees are good.

The total remuneration of employees includes salary, bonuses and allowances. Bonus for any given period is based primarily on individual and our performance. Employees also receive subsidized housing, health benefits and other miscellaneous subsidies.

We have implemented an occupational health and safety program similar to that employed by other international oil and gas companies. Under this program, we closely monitor and record health and safety incidents and promptly report them to government agencies and organizations. On March 15, 2000, we finalized and implemented our occupational health and safety program. We believe this program is broadly in line with the United States government's Occupational Safety & Health Administration guidelines.

All full-time employees in the PRC are covered by a government-regulated pension. The PRC government is responsible for the pension of these retired employees. We are required to contribute monthly approximately 9% to 22% of our employees' salaries, with each employee contributing 4% to 8% of his or her salary for retirement. The contributions vary from region to region.

Our Indonesian subsidiaries employ approximately 900 employees, including approximately 50 expatriates. We provide benefits to expatriates that we believe to be in line with customary international practices. Our local staff in Indonesia enjoy welfare benefits mandated by Indonesian labor laws.

For further details regarding retirement benefits, see note 31 to our consolidated financial statements attached to this annual report.

Health, Safety and Environmental Policy

We are committed to the promotion of the concept and culture of health, safety and environmental ("HSE") protection among all the staff. The oil and gas field development projects that were started during the year all underwent simultaneous reviews on HSE protection in accordance with the laws of the PRC. In 2005, nearly all the staff from the management to the operational level participated in our HSE training sessions. In addition, the scope of our HSE training has been extended to the employees of contractors. More than 10,000 person-time from our contractors participated in our training sessions in 2005.

In 2005, we also placed considerable emphasis on safety in helicopter, diving and vehicle operations. Professional auditors were hired to conduct annual safety audit and safety checks on 11 leased helicopters. In 2006, we plan to carry out special audits on diving operations.

We introduced the system of occupation health profiles to all branches in order to strengthen the health management of offshore operating staff in addition to requiring them to submit health certificates. The submitted health data is to be analyzed so as to offer the staff proactive and constructive advices on health improvement.

As an International Association of Oil and Gas Producer (OGP) member, we assisted OGP in organizing the "Workshop on Safety Management of Offshore Accidents" in 2005.

In 2005, we organized a large-scale offshore emergency drill. There were over 300 participants, including our offshore service contractors and transportation service contractors. We continued to work with other entities to set up Oil Spill Response Base in Tangguh, Longkou, Weizhou and Zhuhai. We believe such initiatives strengthened our capability in handling offshore oil spill emergencies.

In 2005, we made sustained progress in respect of HSE management. During the year, we were neither involved in any material injury liability case, spillage or pollution incidents, nor subject to any safety-related liability claims for losses of over US$120,000. Our OSHA Statistics results continued to be above average when compared with international peers.

We seek to align our operations with international standards and have been applying for the ISO14000 environmental management qualification for our oilfields. By the end of 2005, our

Qinhuangdao 32-6 oilfield and Wenchang oilfields were certified under the ISO14000 environmental management system.

We are a member of the "National Offshore Oil Spillage Response Plan" organized by the State Oceanic Administration. In 2005, we continued to conduct researches and participated in discussions on issues relating to resources sharing and risk assessment in the event of oil spillage offshore China. We also continued to cooperate with the Bohai Bay Oil Spillage Awareness Center and facilitated the establishment of the oil spillage response organizations in the South China Sea.

In accordance with changes to the statistical requirements of the U.S. Occupational Safety and Health Administration, or OSHA, we revised our internal documentation procedures to keep abreast with OSHA's standard, which uses OGP reporting methods to record the differences and standards of particular incidents. We have also adopted new OSHA and incident reporting forms in order to better meet the requirements of international associations such as OGP and API. We deliver working hour statistics and incident reports to investors and API on a quarterly basis.

Human Resources Development

As an oil and gas exploration and production company operating in highly competitive markets, we depend in large part on our employees for effective and efficient operations. We devote significant resources to train our technical employees. During 2005, we held 818 training workshops, which were attended by 12,215 participants. To ensure smooth implementation of our overseas strategy, we have established an international human resources system to attract and retain talents in the international market. During the year, we completed the "Compensation Administration and Adjustment Plan". We also introduced various incentive schemes, including the "Project Team Incentive Scheme" and the "New discovery Incentive Scheme". With respect to overseas staff, we continued to improve our remuneration policy to make it competitive in the international market. We also started to build up an international recruitment database to support our overseas business expansion.

We have adopted four stock option schemes for our senior management since February 4, 2001, and granted options under three of the schemes.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

You should read the following discussion and analysis in conjunction with our consolidated financial statements, selected historical consolidated financial data and operating and reserves data, in each case together with the accompanying notes, contained in this annual report. Our consolidated financial statements have been prepared in accordance with Hong Kong GAAP, which differ in certain material respects from U.S. GAAP. Note 38 to our consolidated financial statements attached to this annual report provides an explanation of our reconciliation to U.S. GAAP of net income and shareholders' equity. Certain statements set forth below constitute "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. See "Forward-Looking Statements."

Overview

We are an oil and gas company engaged in the exploration, development and production of crude oil and natural gas primarily offshore China. We are the dominant producer of crude oil and natural gas offshore China and the only company permitted to conduct exploration and production activities with international oil and gas companies offshore China. As of December 31, 2005, we had estimated net proved reserves of 2,362.6 million BOE, comprised of 1,457.4 million barrels of crude oil and condensate

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and 5,430.9 billion cubic feet of natural gas. In 2005, our net production averaged 356,868 barrels per day of crude oil, condensate and natural gas liquids and 389.6 million cubic feet per day of natural gas, which together totaled 424,108 BOE per day.

Our revenues and profitability are largely determined by our production volume and the prices we realize for our crude oil and natural gas, as well as the costs of our exploration and development activities. Although crude oil prices depend on various market factors and have been volatile historically, our production volume has increased steadily over the past few years.

The following table sets forth our net production of crude oil, condensate and natural gas liquids and net income for the periods indicated.

	Year ended December 31,				
	2001	2002	2003	2004	2005
Net production of crude oil, condensate and natural gas liquids (BOE/day)	228,874	298,625	306,464	319,436	356,868
Net production of natural gas (mmcf/day)	195.0	272.6	291.0	364.1	389.6
Net income (Rmb in millions) (Restated)	7,957.6	9,207.0	11,497.0	16,139.0	25,323.1

We sold 46.9% of our crude oil production in 2005 to customers affiliated with Sinopec or PetroChina in the PRC domestic market. We sold 38.4% of our natural gas production offshore China in 2005 to Castle Peak Power Company Limited in Hong Kong under a long-term take-or-pay contract.

For a further description of these factors and certain other factors affecting our financial performance, see "Item 3--Key Information--Risk Factors."

Relationship with CNOOC

Prior to the October 1999 reorganization of CNOOC, we did not exist as a separate legal entity and our business and operations were conducted by CNOOC and its various affiliates. In connection with the reorganization, CNOOC's oil and gas exploration, development, production and sales business and operations conducted both inside and outside China were transferred to us. See "Item 4--Information on the Company--History and Development--Corporate Structure," "Item 7--Major Shareholders and Related Party Transactions" and note 27 to our consolidated financial statements attached to this annual report.

Before the reorganization, certain PRC affiliates of CNOOC provided various materials, utilities and ancillary services for CNOOC's exploration and production activities. In connection with the reorganization, we entered into various agreements under which we continued to use various services and properties provided by these CNOOC affiliates. These agreements include: (i) a materials, utilities and ancillary services supply agreement; (ii) technical service agreements; (iii) agreements for the sale of crude oil, condensate oil and liquefied petroleum gas; (iv) various lease agreements with other affiliates of CNOOC for office and residential premises used by us; and (v) a research and development services agreement with China Offshore Oil Research Center for the provision of general geophysical exploration services, comprehensive exploration research services, information technology services and seismic study. We have renewed these agreements on substantially the same terms. In 2002, CNOOC consolidated most of its oilfield services operations and established China Oilfield Services Limited. This CNOOC affiliate now provides most of the technical services to us.

For a description of the services provided under these agreements, see "Item 7--Major Shareholders and Related Party Transactions."

Acquisitions and Overseas Activities

On January 1, 2003, we acquired BP Muturi Limited, which owned a 44.0% interest in the Muturi production sharing contract offshore Indonesia, and BP Wiriagar Limited's 42.4% interest in the Wiriagar

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production sharing contract offshore Indonesia for a total consideration of approximately US$275 million. The Muturi production sharing contract and Wiriagar production sharing contract, together with the Berau production sharing contract, make up the Tangguh LNG project. Our interests in these production sharing contracts represented approximately 12.5% of the total reserves and upstream production of the Tangguh LNG project. On May 12, 2004, we completed our acquisition of an additional 20.767% interest in the Muturi production sharing contract from the BG Group. As a result, our interests in these production sharing contracts now represent 16.96% of the total reserves and upstream production of the Tangguh LNG project. The remaining interests are held by BP Berau, BP Muturi, BP Wiriagar, MI Berau, Nippon, BG, KG Berau, KG Wiriagar and Indonesia Natural Gas Resources Muturi. The Tangguh LNG project is a greenfield project located offshore Indonesia and represents one of the largest natural gas projects in Asia.

In connection with our acquisition of interests in the Tangguh LNG project, the partners in the Tangguh LNG project entered into a conditional 25-year supply contract to provide up to 2.6 million tonnes of liquefied natural gas per year to a liquefied natural gas terminal project in Fujian Province, China. Supply of liquefied natural gas under this supply contract is expected to begin in 2008.

In May 2003, we signed an agreement with the original North West Shelf project partners to acquire an aggregate interest of 5.3% in the upstream production and reserves of the North West Shelf project for a consideration of US$348 million, plus an upfront tariff payment relating to certain LNG processing facilities amounting to US$180 million. We also agreed to acquire a 25% interest in the China LNG joint venture established by the North West Shelf project partners to supply liquefied natural gas from the North West Shelf project to a liquefied natural gas terminal currently being developed by CNOOC, our controlling shareholder, and various partners in Guangdong Province, China.

We completed the acquisition in December 2004. Our share of reserves from this project is expected to be approximately 1.2 trillion cubic feet of natural gas. Our share of natural gas together with associated liquids is expected to be approximately 210 million BOE. The partners of the project signed a 25-year LNG supply agreement in December 2004 to provide liquefied natural gas to the Guangdong liquefied natural gas terminal starting 2006. Woodside Petroleum is the operator for the project. See "Item 4--Information on the Company--Business Overview--Natural Gas Business--Overseas Activity."

On October 24, 2003, we entered into an agreement with the joint venture participants of the Gorgon natural gas project in Australia based on a memorandum of understanding previously entered into with them, under which we agreed to acquire certain interest in the upstream production and reserves of the Gorgon natural gas project. The memorandum of understanding expired in March 2005.

At the end of 2004, we and Golden Aaron Pte. Ltd. and China Global Construction Limited formed a joint venture in Myanmar and entered into six production sharing contracts as of June 8, 2005. We will act as the operator under these production sharing contracts.

In early 2005, through our wholly owned subsidiary CNOOC Belgium BVBA, we acquired a 16.69% interest in MEG Energy Corp., a Canada based oil sand company, at a consideration of 150 million Canadian dollars.

On January 8, 2006, we signed an agreement with South Atlantic Petroleum Limited to acquire a 45% working interest in an offshore oil-mining license 130 "OML 130" in Nigeria for a cash consideration of US$2.268 billion. The acquisition was completed in April 2006. We also acquired a 35% working interest in the contract for OPL 229 in Nigeria for a consideration of US$60 million. On February 17, 2006, we signed a production sharing contract for block S in Equatorial Guinea.

On April 28, 2006, through our wholly-owned subsidiary CNOOC Africa Limited, we signed production sharing contracts for six blocks with a total area of 115,343 square kilometers in Kenya.

Production Sharing Contracts Offshore China

We conduct a significant amount of our offshore China oil and gas activities through production sharing contracts with international oil and gas companies. Under these production sharing contracts, our

foreign partners are required to bear all exploration costs during the exploration period. The parties to the contracts may recover exploration costs after commercial discoveries are made and production begins. The amount of exploration costs recoverable is derived from a production sharing formula set forth in each contract. Our production sharing contracts provide us with the option to take participating interests in properties covered by the production sharing contracts which we may exercise after the foreign partners have made viable commercial discoveries. The foreign partners retain the remaining participating interests. We and the foreign partners fund our development and operating costs according to our respective participating interests. Based on a formula contained in the applicable contract, we are entitled to allocate specified amounts of the annual gross production of petroleum from those producing fields. See "Item 4--Information on the Company--Business Overview--Production Sharing Contracts--Offshore China--Production Sharing Formula."

Before we exercise our option to take a participating interest in a production sharing contract, we do not account for the exploration costs incurred, as these costs were incurred by our foreign partners. After we exercise the option to take a participating interest in a production sharing contract, we account for the oil and gas properties using the "proportional method" under which we recognize our share of development costs, revenues and expenses from such operations based on our participating interest in the production sharing contracts. See note 5 to our consolidated financial statements attached to this annual report.

The foreign partners have the right to either take possession of their petroleum for sale in the international market or sell their petroleum to us for resale in the PRC market. See "Item 4--Information on the Company--Business Overview--Production Sharing Contracts--Offshore China."

As described above, production of crude oil and natural gas is allocated among us, our foreign partners and the PRC government according to a formula contained in the production sharing contracts. We have excluded the government's share oil from net sales in our historical consolidated financial statements. Since our historical consolidated financial statements already exclude the government's share oil from our net sales figure, we do not expect any future share oil payments to affect our results of operations or operating cash flows differently than the effects reflected in our historical consolidated financial statement. For information regarding the historical amounts of government share oil payable to the government, see note 5 to our consolidated financial statements attached to this annual report. For information regarding treatment of the PRC government's share oil, see "Item 4--Information on the Company--Business Overview--Production Sharing Contracts--Offshore China--Production Sharing Formula."

Shanghai Petroleum and Natural Gas Company Limited, which owns the Pinghu field, is our associated company. Our 30% equity interest in this company is accounted for using the equity method, under which our proportionate share of the net income or loss of Shanghai Petroleum and Natural Gas Company Limited is included in our consolidated statements of income as a share of income or loss of the associated company.

Our cost structures for production sharing contracts and for independent operations are different. The total expenses per unit of production under production sharing contracts are generally higher due to our foreign partners' use of expatriate staff, who generally command higher wages, as well as administrative and overhead costs that may be allocated by the operators, a higher percentage of capital expenditures and larger proportion of imported equipment.

Production from Independent Operations offshore China versus Production from Production Sharing Contracts offshore China

Historically we have cooperated with foreign partners under production sharing contracts, which have provided us with the expertise to undertake our independent operations more effectively. The percentage of our net production arising from independent operations offshore China was 52.7%, 49.6% and 50.2%, respectively, for the years ended December 31, 2003, 2004 and 2005, respectively. Although

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we will continue to focus on independent operations, we plan to continue seeking appropriate opportunities to cooperate with foreign partners under production sharing contracts.

Provision for dismantlement

Prior to 2002, we estimated future dismantlement costs for our oil and gas properties and accrued the costs over the economic lives of the assets using the unit-of-production method. We estimated future dismantlement costs for oil and gas properties with reference to the estimates provided from either internal and external engineers after taking into consideration the anticipated method of dismantlement required in accordance with then current legislation and industry practice. In 2002, we changed the method of accounting for the provision for dismantlement in compliance with Hong Kong Statement of Standard Accounting Practice or HK SSAP 28 (HKAS 37 replaced HK SSAP 28 in 2005), "Provisions, contingent liabilities and contingent assets." HK SSAP 28 requires the provision to be recorded for a present obligation whether that obligation is legal or constructive. The associated cost is capitalized and the liability is discounted and accretion expense is recognized using the credit adjusted risk-free rate in effect when the liability is initially recognized. The dismantlement costs for the years ended December 31, 2003, 2004 and 2005 were Rmb 167.3 million, Rmb 201.6 million and Rmb 252.9 million, respectively. The accrued liability is reflected in our consolidated balance sheet under "provision for dismantlement." See note 28 to our consolidated financial statements attached to this annual report.

Production Imbalance

We account for oil overlifts and underlifts using the entitlement method, under which we record overlifts as liabilities and underlifts as assets. An overlift occurs when we sell more than our percentage interest of oil from a property subject to a production sharing contract. An underlift occurs when we sell less than our participating interest of oil from a property under a production sharing contract. During the historical periods presented in our consolidated financial statements attached to this annual report, we had no gas imbalances. We believe that production imbalance has not had a significant effect on our operations, liquidity or capital resources.

Allowances for Doubtful Accounts

We evaluate our accounts receivable by considering the financial condition of our customers, their past payment history and credit standing and other specific factors, including whether the accounts receivable in question are under dispute. We make provisions for accounts receivable when they are overdue for six months and we are concerned about our ability to collect them. For the year ended December 31, 2003, 2004 and 2005, allowances for doubtful accounts were not material in the context of total operating expenses and did not have a material effect on our results of operations or financial condition.

Critical Accounting Policies

We prepare our consolidated financial statements in accordance with Hong Kong GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of our assets and liabilities, the disclosure of our contingent assets and liabilities as of the date of our financial statements and the reported amounts of our revenues and expenses during the periods reported. Management makes these estimates and judgments based on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe that the following significant accounting policies may involve a higher degree of judgment in the preparation of our consolidated financial statements. For additional discussion of our significant accounting policies, see note 3 to our consolidated financial statements attached to this annual report.

Oil and Gas Properties

For oil and gas properties, we have adopted the successful efforts method of accounting. As a result, we capitalize initial acquisition costs of oil and gas properties and recognize impairment of initial

acquisition costs based on exploratory experience and management judgment. Upon discovery of commercial reserves, we transfer acquisition costs to proved properties and capitalize the costs of drilling and equipping successful exploratory wells, all development costs, and the borrowing costs arising from borrowings used to finance the development of oil and gas properties before they are substantially ready for production. We treat the costs of unsuccessful exploratory wells and all other related exploration costs as expenses when incurred. We amortize capitalized acquisition costs of proved properties by the unit-of-production method on a property-by-property basis based on the total estimated units of proved reserves. We estimate future dismantlement costs for oil and gas properties with reference to the estimates provided from either internal or external engineers after taking into consideration the anticipated method of dismantlement required in accordance with current legislation and industry practices. The associated cost is capitalized and the liability is discounted and an accretion expense is recognized using the credit-adjusted risk-free interest rate in effect when the liability is initially recognized.

Impairment of Assets

We make an assessment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, or when there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. In any event, we would make an estimate of the asset's recoverable amount, which is calculated as the higher of the asset's value in use or its net selling price. We recognize an impairment loss only if the carrying amount of an asset exceeds its recoverable amount. We charge an impairment loss to the income statement in the period in which it arises unless the asset is carried at a revalued amount. For a revalued asset, we account for the impairment loss in accordance with the relevant accounting policy for such revalued asset. A previously recognized impairment loss is reversed only if there has been a change in our estimates used to determine the recoverable amount of an asset. However, no reversal may put the value of the asset higher than the carrying amount that we would have determined (net of any depreciation/amortization) had no impairment loss been recognized for the asset in prior years.

A reversal of an impairment loss is credited to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

Provisions

We recognize a provision when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation so long as a reliable estimate can be made of the amount of the obligation. When the effect of discounting is material, the amount recognized for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement. We make provisions for dismantlement based on the present value of our future costs expected to be incurred, on a property-by-property basis, in respect of our expected dismantlement and abandonment costs at the end of the related oil exploration and recovery activities.

Deferred Tax

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Recognition of Revenue from Oil and Gas Sales and Marketing

We recognize revenue when it is probable that the economic benefits will flow to us and when the revenue can be measured reliably. For oil and gas sales, our revenues represent the invoiced value of sales of oil and gas attributable to our interests, net of royalties and any government share oil that is lifted and sold on behalf of the PRC government. Sales are recognized when the significant risks and rewards

of ownership of oil and gas have been transferred to customers. Oil and gas lifted and sold by us above or below our participating interests in any production sharing contract result in overlifts and underlifts. We record these transactions in accordance with the entitlement method under which overlifts are recorded as liabilities and underlifts are recorded as assets at year-end oil prices. Settlement will be in kind when the liftings are equalized or in cash when production ceases. We enter into gas sales contracts with customers which typically contain take-or-pay clauses. These clauses require our customers to take a specified minimum volume of gas each year. If a customer fails to take the minimum volume of gas, the customer must pay for the gas even though it did not take the gas. The customer can offset the deficiency payment against any future purchases in excess of the specified volume. We record any deficiency payment as deferred revenue which is included in other payables until any make-up gas is taken by the customer or the expiry of the contract. Our marketing revenues represent sales of oil purchased from the foreign partners under our production sharing contracts and revenues from the trading of oil through our subsidiary in Singapore. The title, together with the risks and rewards of the ownership of such oil purchased from the foreign partners, are transferred to us from the foreign partners and other unrelated oil and gas companies before we sell such oil to our customers. The cost of the oil sold is included in crude oil and product purchases.

Results of Operations

Overview

The following table summarizes the components of our revenues and net production as percentages of our total revenues and total net production for the periods indicated:

	Year ended December 31,		
	2003	2004	2
	(Rmb in millions, except percentages, production data and		

Revenues:					
Oil and gas sales: (1)					
Crude oil	25,792	63.0%	34,081	61.7%	50,361
Natural gas	2,325	5.7%	2,805	5.1%	3,057
Total oil and gas sales ...	28,117	68.7%	36,886	66.8%	53,418
Marketing revenues	12,398	30.3%	18,191	32.9%	15,901
Other income	435	1.1%	145	0.3%	137
Total revenues	40,950	100.0%	55,222	100.0%	69,456
Net production (million BOE):					
Crude oil	111.9	85.9%	116.9	83.5%	130.3
Natural gas	18.3	14.1%	23.1	16.5%	24.5
Total net production	130.2	100.0%	140.0	100.0%	154.8
Average net realized prices:					
Crude oil (per bbl)......	US$28.11		US$35.41		US$47.31
Natural Gas (per mcf)....	2.87		2.75		2.82

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(1) These figures do not include our revenues from the Pinghu gas field.

The following table sets forth, for the periods indicated, certain income and expense items in our consolidated income statements as a percentage of total revenues:

	Year ended December 31	
	2003	2004
Operating Revenues:	(based on restated amounts)	
Oil and gas sales	68.7%	66.8%
Marketing revenues	30.2	32.9
Other income	1.1	0.3
Total revenues	100.0%	100.0%
Expenses:		
Operating expenses	(11.0)%	(9.2)%

Production taxes	(3.0)	(3.1)
Exploration costs	(2.1)	(2.4)
Depreciation, depletion and amortization	(11.3)	(9.9)
Dismantlement	(0.4)	(0.4)
Impairment losses related to property, plant and equipment	(0.0)	(0.0)
Crude oil and product purchases	(29.9)	(32.5)
Selling and administrative expenses	(3.1)	(1.9)
Other	(0.9)	(0.1)

	(61.7)%	(59.5)%
Interest income	0.4%	0.4%
Finance costs	(0.9)	(0.8)
Exchange gain (loss), net	(0.0)	0.1
Short term investment income	0.3	0.1
Share of profit of an associate	0.5	0.6
Non-operating profit (loss), net	0.8	0.9
Income before tax	39.4	41.8
Tax	(11.3)	(12.6)
Net income	28.1%	29.2%

Calculation of Revenues

China

We report total revenues, which consist of oil and gas sales, marketing revenues and other income, in our consolidated financial statements attached to this annual report. With respect to revenues derived from our offshore China operations, oil and gas sales represent gross oil and gas sales less royalties and share oil payable to the PRC government. These amounts are calculated as follows:

o gross oil and gas sales consist of our percentage interest in total oil and gas sales, comprised of (i) a 100% interest in our independent oil and gas properties and (ii) our participating interest in the properties covered under our production sharing contracts, less an adjustment for production allocable to foreign partners under our production sharing contracts as reimbursement for exploration expenses attributable to our participating interest;

o royalties represent royalties we pay to the PRC government on production with respect to each of our oil and gas fields. The amount of royalties varies from 0% up to 12.5% based on the annual production of the relevant property. We pay royalties on oil and gas we produce independently and under production sharing contracts;

o government share oil, which is only paid on oil and gas produced under production sharing contracts, is calculated as described under "--Overview--Production Sharing Contracts Offshore China;"

o other income mainly represents project management fees charged to our foreign partners and handling fees charged to end customers--both fees are recognized when the services are rendered; and

o we pay production taxes to the PRC government that are equal to 5% of the oil and gas we produce independently and under production sharing contracts. Our oil and gas sales are not reduced by production taxes. Production taxes are included in our expenses under "production taxes."

Marketing revenues represent our sales of our foreign partners' oil and gas produced under our production sharing contract and purchased by us from our foreign partners under such contracts as well as from international oil and gas companies through our wholly owned subsidiary in Singapore. Net marketing revenues represent the marketing revenues net of the cost of purchasing oil and gas from foreign partners and from international oil and gas companies. Our foreign partners have the right to

either take possession of their oil and gas for sale in the international market or to sell their oil and gas to us for resale in the PRC market.

Our share of the oil and gas sales of our associated company is not included in our revenues, but our share of the profit or loss of our associated company is included in our consolidated statements of income under "share of profit of associates."

Indonesia

The oil and gas sales from our subsidiaries in Indonesia consist of our participating interest in the properties covered under the relevant production sharing contracts, less adjustments for share oil payable under our Indonesian production sharing contracts and for a domestic market obligation under which the contractor must sell a specified percentage of its crude oil to the local Indonesian market at a reduced price.

2005 versus 2004

The discussions under "--2005 versus 2004" are based on the restated amounts, where applicable, as a result of the adoption of new HKFRSs. See note 2.4 to our consolidated financial statements under "Item 18-Financial Statement" in this annual report.

Consolidated Net Profit

Our consolidated net income after tax was Rmb 25,323.1 million (US$3,137.9 million) in 2005, an increase of Rmb 9,184.0 million (US$1,138.0 million), or 56.9%, from Rmb 16,139.1 million in 2004.

Revenue

Our oil and gas sales for 2005 were Rmb 53,417.7 million (US$6,619.1 million), an increase of Rmb 16,531.7 million (US$2,048.5 million), or 44.8%, from Rmb 36,886.0 million in 2004. The increase primarily reflects the rise in global crude oil prices and production grants. Our sales volume of crude oil and natural gas in 2005 increased by 11.6% and 6.8%, respectively, as compared to 2004. The average realized price for our crude oil was US$47.31 per barrel in 2005, an increase of US$11.9, or 33.6% from US$35.41 per barrel in 2004. The average realized price of natural gas was US$2.82 per thousand cubic feet in 2005, an increase of US$0.07, or 2.6%, from US$2.75 per thousand cubic feet in 2004.

In 2005, our net marketing profit, which were derived from marketing revenue less purchase cost of crude oil and oil products, were Rmb 197.2 million (US$24.4 million), a decrease of Rmb 30.7 million (US$3.8 million), or 13.5%, from Rmb 227.9 million in 2004. Since we are one of the three companies that have the right to sell crude oil in China, upon request by our production sharing contract partners, we may purchase the oil of these partners for sale in China. However, the amount of oil we may purchase and sell in China depends on our foreign partners and, therefore, we cannot control the amount of crude oil that we are able to sell for any specific period. In 2005, marketing revenue from our wholly-owned subsidiary, CNOOC China Limited, was Rmb 9,430.8 million

(US$1,168.6 million), representing an increase of Rmb 1,688.2 million (US$209.2 million) from Rmb 7,742.6 million in 2004. The net marketing profit, however, decreased Rmb 71.6 million, or 45.7%, from Rmb 156.6 million in 2004. The decrease was primarily due to the significant reduction in sales margin which was mainly influenced by market prices in the local markets. The net marketing profit from our wholly-owned subsidiary, China Offshore Oil (Singapore) International Pte Ltd., was Rmb 112.2 million (US$13.9 million), an increase of Rmb 40.9 million, or 57.4%, from Rmb 71.3 million in 2004.

Our other income, reported on a net basis, was derived from our other income less corresponding costs. In 2005, the total other income was Rmb 59.7 million (US$7.4 million), a decrease of Rmb 39.1 million (US$4.8 million) from Rmb 98.8 million in 2004. The decrease was primarily due to the lower service fees received from our production sharing contract projects.

Expenses

Operating expenses. Our operating expenses were Rmb 5,934.6 million (US$735.4 million) in 2005, an increase of Rmb 864.3 million (US$107.1 million), or 17.0%, from Rmb 5,070.3 million in 2004. The increase was mainly attributable to the commencement of production of seven new oil and gas fields in China in 2005. Operating expenses in 2005 were Rmb 38.8 (US$4.8) per BOE, an increase of 5.7% from Rmb 36.7 per BOE in 2004. Operating expenses for our offshore China operations in 2005 were Rmb 32.5 (US$4.0) per BOE, representing an increase of 8.7% from 2004. The increase was mainly attributable to the higher service fees, supply vessels, equipment lease, maintenance materials, chemicals and fuel, resulting from the higher international crude oil price. Operating expenses for our offshore Indonesia operations were Rmb 100.2 (US$12.4) per BOE, an increase of 13.0% over 2004. The increase in operating expenses per barrel for our Indonesian oil fields was due to lower net production volume based on their profit sharing models. Based on working interest production, operating expenses for our offshore Indonesia operations in 2005 were Rmb 48.7 (US$6.0) per BOE.

Production taxes. Our production taxes for 2005 were Rmb 2,596.5 million (US$321.7 million), an increase of Rmb 870.8 million (US$107.9 million), or 50.5% from Rmb 1,725.7 million in 2004. The increase was primarily due to the increased income from oil and gas sales.

Exploration costs. Our exploration costs for 2005 were Rmb 1,293.7 million (US$160.3 million), a slight decrease of Rmb 22.5 million (US$2.8 million), or 1.7%, from Rmb 1,316.2 million in 2004, as a result of an increase in capitalization of investment in exploration activities.

Depreciation, depletion and amortization expenses. Our depreciation, depletion and amortization expenses for 2005 were Rmb 5,964.7 million (US$739.1 million), an increase of Rmb 509.6 million (US$63.1 million), or 9.3%, from Rmb 5,455.1 million in 2004. On a unit of production basis, depreciation, depletion and amortization expenses for 2005 were Rmb 39.0 (US$4.8) per BOE, as compared to Rmb 39.5 per BOE in 2004.

Dismantlement costs. Our dismantlement costs for 2005 were Rmb 252.9 million (US$31.3 million), an increase of Rmb 51.3 million (US$6.4 million), from Rmb 201.6 million in 2004. The increase was primarily due to the increased dismantling costs resulting from the commencement of production at new oil and gas fields and a revision of the dismantlement liabilities for certain existing oil and gas fields. Our dismantlement costs were Rmb 1.7 (US$0.2) per BOE, a corresponding increase from Rmb 1.5 per BOE in 2004.

Impairment losses related to property, plant and equipment. Our impairment losses for 2005 were Rmb 90.2 million (US$11.2 million). The impairment was due to the downward revision of the reserve of BZ34-2/4 and HZ19-3 oil and gas fields. The average impairment costs were Rmb 0.6 (US$0.07) per BOE.

Selling and administrative expenses. Our selling and administrative expenses for 2005 were Rmb 1,370.4 million (US$169.8 million), an increase of Rmb 266.1 million (US$33.0 million), or 24.1%, from Rmb 1,104.3 million in 2004. Of which, our selling and administrative expenses of companies in China in 2005 were Rmb 6.3 (US$0.8) per BOE, an increase of 14.5% over 2004.
Compared with 2004, the increase was mainly attributable to an increase in management fees related to the increased number of production sharing contract projects under production, and increases in labor costs and general research expenditure in 2005.

Finance costs, net of interest income

Our net finance costs for 2005 was Rmb 741.2 million (US$91.8 million), an increase of 215.5%, from the net interest expenses of Rmb 235.0 million in 2004. On the one hand, our interest income increased by Rmb 152.4 million from Rmb 206.9 million in 2004 to Rmb 359.3 million in 2005. On the other hand, the finance costs increased significantly mainly due to the interest expenses on our US$1 billion bonds issued in December 2004, the losses on fair value changes of the embedded derivative component of the convertible bonds and the effect of increased amount of provision of dismantlement arising from the passage of time. The increases due to the factors mentioned above were Rmb 164.4

million (US$20.4 million), Rmb 373.1 million (US$46.2) and Rmb 79.2 million (US$9.8 million), respectively.

Exchange Gain/Loss, net

Our net exchange gain for 2005 was Rmb 287.0 million (US$35.6 million), an increase of Rmb 257.7 million (US$31.9 million), from net exchange gains of Rmb 29.3 million in 2004. Compared with 2004, the increased exchange gains mainly came from the Chinese government's efforts on the improvement of rate-forming mechanism and the following appreciation of Renminbi in the second half of the year.

Investment Income

Our short term investment income for 2005 was Rmb 247.9 million (US$30.7 million), a significant increase of Rmb 175.5 million (US$21.7 million), or 242.4%, from Rmb 72.4 million in 2004. For the purpose of improving performance of current assets portfolio, we increased the investment in financial instruments such as money market funds. Benefiting from the structural changes in the investment portfolio and the influence from the market, we obtained a favorable return in this year.

Share of Profits of Associates

In 2005, there were gains from our investments in Shanghai Petroleum and Natural Gas Company Limited and CNOOC Finance Corporation Limited. Of them, share of profit from Shanghai Petroleum and Natural Gas Company Limited was Rmb 261.8 million (US$32.4 million), representing a decrease of 12.1% from 2004, which was mainly due to the change in tax rate from favorable rate of 16.5% to normal rate of 33.0% and resulting from the increased income tax payment of 2005. Share of profit from CNOOC Finance Corporation Limited was Rmb 45.3

million (US$5.6 million) during the period, relatively comparable to that from 2004.

Non-operating Income/Expenses, Net

Our net non-operating income for 2005 was Rmb 28.6 million (US$3.5 million), as compared to non-operating income of Rmb 519.2 million for 2004. In 2004, the net non-operating income represented the tax refund from re-investment in China.

Income tax

Our income tax for 2005 was Rmb 10,977.8 million (US$1,360.3 million), an increase of Rmb 4,047.0 million (US$501.5 million), or 58.4%, from Rmb 6,930.8 million in 2004. The primary reason for the increase was the increase in profit before tax. The effective tax rate for 2005 was 30.2%, slightly higher than the effective rate of 30.0% in 2004.

2004 versus 2003

The discussions under "--2004 versus 2003" are based on the restated amounts, where applicable, as a result of the adoption of new HKFRSs. See note 2.4 to our consolidated financial statements under "Item 18 - Financial Statements" in this annual report.

Consolidated Net Profit

Our consolidated net income after tax was Rmb 16,139.1 million in 2004, an increase of Rmb 4,641.4 million, or 40.4%, from Rmb 11,497.7 million in 2003.

Revenue

Our oil and gas sales for 2004 were Rmb 36,886.0 million, an increase of Rmb 8,769.2 million or 31.2%, from Rmb 28,116.8 million in 2003. The increase primarily reflects the rise in global crude oil prices and our higher production level. Our sales of crude oil and natural gas in 2004 increased by 5% and 26%, respectively, as compared to 2003. The average realized price for our crude oil was US$35.41 per barrel in 2004, an increase of US$7.3, or 26.0% from US$28.11 per barrel in 2003. The average realized price of natural gas was US$2.75 per thousand cubic feet in 2004, a decrease of US$0.12, or 4.2%, from US$2.87 per thousand cubic feet in 2003. The decrease was due to the increased weighting of production of low-priced gas fields.

In 2004, our net marketing profit, which were derived from marketing revenue less purchase cost of crude oil and oil products, were Rmb 227.9 million, an increase of Rmb 124.5 million, or 120.3%, from Rmb 103.4 million in 2003. Since we are one of the three companies that have the right to sell crude oil in China, upon request by our production sharing contract partners, we may purchase the oil of these partners for sale in China. However, the amount of oil we may purchase and sell in China depends on our foreign partners and, therefore, we cannot control the amount of crude oil that we are able to sell for any specific period. In 2004, our marketing profit from our wholly owned subsidiary, China Offshore Oil (Singapore) International Pte Ltd., was Rmb 71.3 million, an increase of 36.1% from Rmb 52.4 million in 2003.

Our other income, reported on a net basis, was derived from our other income less corresponding costs. In 2004, the total other income was Rmb 98.8 million, an increase of Rmb 14.3 million (US$1.7 million) from Rmb 84.5 million in 2003.

Expenses

Operating expenses. Our operating expenses were Rmb 5,070.3 million in 2004, an increase of Rmb 557.5 million, or 12.4%, from Rmb 4,512.8 million in 2003. The increase primarily resulted from the increased operating expenses in connection with the commencement of operations in new properties. Operating expenses were Rmb 36.7 per BOE in 2004, an increase of 4.2% from Rmb 35.2 per BOE in 2003. Operating expenses offshore China in 2004 were Rmb 29.9 per BOE, an increase of 10.7% from Rmb 27.0 per BOE in 2003. Operating expenses offshore Indonesia were Rmb 88.7 per BOE, an increase of 15.6% from Rmb 76.7 per BOE in 2003. The increases were primarily due to the high international crude oil prices and an increase in operating expenses per barrel for our Indonesian oilfields due to their lower production volume based on their profit sharing model. Based on working interest production, operating expenses for our offshore Indonesia operations in 2004 were Rmb 42.0 per BOE, which were in line with the operating expenses for our offshore Indonesia operations in the previous year.

Production taxes. Our production taxes for 2004 were Rmb 1,725.7 million, an increase of Rmb 487.1 million, or 39.3%, from Rmb 1,238.6 million in 2003. The increase was primarily due to increase in oil and gas sales in 2004.

Exploration costs. Our exploration costs for 2004 were Rmb 1,316.2 million, an increase of Rmb 468.1 million, or 55.2%, from Rmb 848.1 million in 2003. The increase was primarily due to a significant increase in exploration activities. In 2004, some successful exploration wells were written off because we did not expect to develop these wells within the next couple years. The write-off amount was Rmb 155.8 million.

Depreciation, depletion and amortization expenses. Our depreciation, depletion and amortization expenses for 2004 were Rmb 5,455.1 million, an increase of Rmb 812.3 million, or 17.5%, from Rmb 4,642.8 million in 2003. On a unit of production basis, depreciation, depletion and amortization expenses for 2004 were Rmb 39.5 per BOE, an increase of 9.2% compared to Rmb 36.2 per BOE in 2003. The primary reason for the increase was the higher amortization costs for the oilfields that commenced operations in 2004 and the lower production level of the Indonesian oilfields. Based on our profit sharing model, our production level of our Indonesian oilfields is directly affected by oil price fluctuation.

Dismantlement costs. Our dismantlement costs for 2004 were Rmb 201.6 million, an increase of Rmb 34.3 million, or 20.5%, from Rmb 167.3 million in 2003. The increase was primarily due to the increased dismantlement costs resulting from the commencement of production at new oil and gas properties. On a unit production basis, our dismantlement costs were Rmb 1.5 per BOE, an increase of 15.3% compared to Rmb 1.3 per BOE in 2003.

Selling and administrative expenses. Our selling and administrative expenses for 2004 were Rmb 1, 104.3 million, a decrease of Rmb 145.9 million, or 11.7%, from Rmb 1,250.3 million in 2003. The primary reason for the decrease was a decrease in labor costs resulting from the direct charge of some labor costs to specific projects and the replacement of some foreign employees that received higher salaries with local employees. On a unit of production basis, selling and administrative expenses were Rmb 8.0 per BOE in 2004, a decrease of 19.1% from Rmb 9.7 per BOE in 2003. Our selling and administrative expenses in China in 2004 were Rmb 5.5 per BOE, a decrease of 17.9% from 2003.

Net interest expenses/income

Our net interest expense for 2004 was Rmb 235.0 million, an increase of Rmb 63.6 million, or 37.1%, from Rmb 171.4 million in 2003. The increase was primarily due to the interest expenses on our US$500 million bonds issued in 2003. Rmb 94.8 million of the increase in interest expense was attributable to our long term guaranteed notes.

Exchange Gain/Loss, net

Our net exchange gain for 2004 was Rmb 29.3 million, compared with a net exchange loss of Rmb 6.7 million in 2003. The exchange gain in 2004 was mainly attributable to our foreign currency swaps for our yen-denominated loans.

Short Term Investment Income

Our short term investment income for 2004 was Rmb 72.4 million, a decrease of Rmb 51.1 million, or 41.4%, from Rmb 123.5 million in 2003. The decrease was primarily due to the structural change to our investment portfolio, where we disposed of some of our investment in corporate bonds and reinvested the proceeds in market funds.

Share of Profit of Associates

Our share of profit of associates for 2004 was Rmb 344.5 million, an increase of Rmb 124.2 million, or 56.4%, from Rmb 220.3 million in 2003. This item reflected our share of profit generated by Shanghai Petroleum and Natural Gas Company Limited resulting primarily from increases in production and oil prices and our share of profit generated by CNOOC Finance Corporation Limited.

Non-operating Income/Expenses, Net

Our net non-operating income for 2004 was Rmb 519.2 million, compared to non-operating income of Rmb 315 million for 2003. In 2004, the net non-operating income was mainly due to the tax refund from re-investment in China.

Income tax

Our income tax for 2004 was Rmb 6,930.8 million, an increase of Rmb 2,303.0 million, or 49.8%, from Rmb 4,627.8 million in 2003. The primary reason for the increase was the increase in profit before tax. In 2003, we received Rmb 252.0 million tax rebate for using domestic equipment. The effective tax rate for 2004 was 30.0%, as compared with the effective rate of 28.7% in 2003.

B. LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our cash flows for the periods presented:

	Year ended December 31,		
	2003	2004	2005
	(Rmb in millions)		
Cash provided by (used for):			
Operating activities	17,819	22,328	32,154
Investing activities	(9,513)	(24,607)	(29,349)
Financing activities	(1,745)	1,970	(7,787)

Net increase/(decrease) in cash and cash equivalents	6,561	(309)	(4,982)

Cash Provided by Operations

Net cash generated from operating activities in 2005 amounted to Rmb 32,153.8 million (US$3,984.3 million), representing an increase of Rmb 9,825.9 million (US$1,217.6 million), or 44.0% from Rmb 22,327.9 million in 2004. The increase was primarily due to an increase in profit before tax of Rmb 13,231.0 million (US$1,639.5 million), an increase in depreciation, depletion and amortization expenses of Rmb 509.7 million (US$63.2 million), an increase in finance costs of Rmb 658.7 million (US$81.6 million), an increase in provision for inventory of Rmb 35.8 million (US$4.4 million), an increase in dismantlement costs of Rmb 51.2 million (US$6.3 million), a decrease in share of profits of associates of Rmb 37.4 million (US$4.6 million), an increase in amortization of discount of long term guaranteed notes of Rmb 26.3 million (US$3.3 million), and an increase in impairment losses related to property, plant and equipment of Rmb 90.2 million (US$11.2 million).

Increase of cash flow was also partially offset by an increase of income tax paid of Rmb 2,447.2 million (US$303.2 million), an increase in our finance exchange gain and loss of Rmb 257.8 million (US$31.9 million), an increase in investment income received of Rmb 175.5 million (US$21.7 million), a decrease in the loss on disposal and write off of property, plant and equipment of Rmb 14.3 million (US$1.8 million), an increase in interest income of Rmb 152.4 million (US$18.9 million) and a decrease in compensation cost for share based payment of Rmb 17.5 million (US$2.2 million).

In another aspect, compared with 2004, the increase in operating cash flow was partially attributable to the increase in changes of working capital, mainly due to the increase in changes of current assets from operating activities excluding cash and bank balances of Rmb 2,103.9 million (US$260.7 million), and a simultaneous increase in changes of current liabilities from operating activities of Rmb 71.0 million (US$8.8 million).

Capital Expenditures and Investments

Net cash outflow from investing activities in 2005 was Rmb 29,349.2 million (US$3,636.7 million), representing an increase of Rmb 4,742.0 million (US$587.6 million), from Rmb 24,607.2 million in 2004. In line with our use of "successful efforts" method of accounting, total capital expenditures and investments primarily include successful exploration and development expenditures and purchasing costs of oil and gas properties. Total capital expenditures were Rmb 17,469.5 million (US$2,164.7 million) in 2005, representing a decrease of Rmb 1,152.5 million (US$142.8 million), or 6.2%, from Rmb 18,622.0 million in 2004.

The capital expenditures in 2005 mainly comprised of Rmb 875.8 million (US$108.5 million) for capitalized exploration activities, Rmb 15,729.7 million (US$1,949.1 million) for development activities, and Rmb 1,017.0 million (US$126.0 million) for acquiring 16.69% equity interest in MEG, netting off a tax refund of Rmb 153.0 million (US$ 19.0 million) for the North West Shelf project in Australia. Our development expenditures in 2005 related principally to the development of PanYu 30-1, Bozhong 25-1/25-1S, PL19-3 phase II and NanPu 35-2 oil and gas fields.

In addition, cash outflow was attributable to the increase in time deposits with maturities over three months of Rmb 3,597 million (US$445.7 million), and the net purchase of available-for-sale financial assets of Rmb 8,282.7 million (US$1,026.3 million).

Total capital expenditures were Rmb 18,622.0 million in 2004, an increase of Rmb 6,249.5 million, or 50.5%, from Rmb 12,372.5 million in 2003. The capital expenditures in 2004 included Rmb 783.5 million for capitalized exploration activities, Rmb 12,059.4 million for development activities, and Rmb 5,779.1 million for acquiring the Tangguh LNG project, the North West Shelf project and other oil and gas properties. Our development expenditures in 2004 related principally to the development of Bozhong 25-1/25-1S, Luda, Bonan and Caofeidian oil and gas fields. In addition, cash outflow in 2004 was in part attributable to an increase in time deposits with maturities over three months of Rmb 6,280 million, which was partially offset by cash inflow from net disposal of short-term investment of Rmb 294.8 million.

For 2006, we have budgeted approximately US$3.08 billion for capital expenditures, approximately US$316.3 million of which is budgeted for general exploration activities offshore China, approximately US$1,860.1 million of which is budgeted for development activities offshore China and approximately US$514.5 million of which is budgeted for our exploration and development activities overseas.

The following table sets forth actual or budgeted capital expenditures on an accrual basis for our key operating areas for the periods indicated.

	Year ended December 31,	
	2005(1)	2006(2)
Operating Area:	(US$ in millions)	
Bohai Bay		
Development	856.4	1,099.5
Exploration	84.3	136.5
Western South China Sea		
Development	161.3	441.3
Exploration	76.0	113.4
East China Sea		
Development	105.0	30.3
Exploration	6.3	12.1
East South China Sea		
Development	554.1	271.5
Exploration	52.9	32.9
Other Offshore China		
Development	--	17.4
Exploration	13.4	21.4
Overseas		
Development	288.5	373.1
Exploration	19.6	141.4
Total	2,217.7	2,690.8

(1) Figures for 2005 represent our actual spending for capital expenditure purposes.
(2) Figures for 2006 represent our budgeted capital expenditures.

In addition to the budgeted development and exploration expenditures relating to the oil and gas properties described above, we may make additional capital expenditures and investments in these periods consistent with our business strategy. See "Item 4--Information on the Company--Business Overview--Business Strategy."

Our ability to maintain and grow our revenues, net income and cash flows depends upon continued capital spending. We adjust our capital expenditure and investment budget on an annual basis. Our capital expenditure plans are subject to a number of risks, contingencies and other factors, some of

which are beyond our control. Therefore, our actual future capital expenditures and investments will likely be different from our current planned amounts, and such differences may be significant. See "Item 3--Key Information--Risk Factors--Risks relating to our business--Our future prospects largely depend on our capital expenditure plans, which are subject to various risks."

Financing activities

The net cash outflow arising from financing activities in 2005 was Rmb 7,786.4 million (US$964.8 million) as compared to a net cash inflow of Rmb 1,970.5 million from financing activities in 2004. There was no issuance of debt financing instruments or bank loan increase in 2005. The net cash outflow in 2005 was primarily due to the distribution of dividends of Rmb 7,772.2 million (US$963.1 million) and the repayment of bank loans of Rmb 18.7 million (US$2.3 million). Some cash inflow was generated by the proceeds from the exercise of share options of Rmb 4.5 million (US$0.6 million) in 2005.

We had net cash inflows from financing activities of Rmb 1,970.5 million in 2004, primarily attributable to the convertible bond issuance which generated cash inflow of approximately Rmb 8,154.1 million. The cash inflows were partially offset by our repayment of Rmb 21.1 million in bank loans, dividend distributions of Rmb 6,101.4 million and a cash outflow of Rmb 61.2 million resulting from our share repurchases in 2004.

We have debt service obligations consisting of principal and interest payments on our outstanding indebtedness. The following table summarizes the maturities of our long-term debt outstanding as of December 31, 2005. As of the date this annual report is filed, we have not incurred any material long-term debt since December 31, 2005.

	Debt maturities (principal only)				
	Original currency				
Due by December 31,	US$	JPY	Rmb	Total Rmb equivalents	Total US$ equivalents
	(in millions, except percentages)				
2006	100.0	271.5	--	825.7	102.3
2007-2009	1,000.0	271.4	--	8,088.9	1,002.3
2010-2011	--	--	--	--	--
2011 and beyond	1,000.0	--	--	8,070.2	1,000.0
Total	2,100.0	542.9	--	16,984.8	2,104.6
Percentage of total debt	99.8%	0.2%	--	100.0%	100.0%

As of June 6, 2006, we had a total U.S. dollar debt of US$2,100.0 million and a total foreign currency debt of US$2,104.6 million.

After we became a separate entity in October 1999, we paid a dividend of Rmb 1,045.4 million in 1999 and declared and paid a final dividend of Rmb 6,426.4 million in 2000. In 2002, 2003 and 2004, we paid dividends totaling Rmb 2,265.1 million, Rmb 5,403.7 million and Rmb 6,101.4 million, respectively. In 2005, we declared and paid dividends totaling Rmb 7,772.2 million (US$963.1 million). The payment and the amount of any dividends in the future will depend on our results of operations, cash flows, financial condition, the payment by our subsidiaries of cash dividends to us, future prospects and other factors which our directors may consider relevant. The amount of dividends we paid historically is not indicative of the dividends that we will pay in the future.

We believe our future cash flows from operations, borrowing capacity and funds raised from our debt offerings will be sufficient to fund planned capital expenditures and investments, debt maturities and working capital requirements through at least 2006. Several large financial institutions have expressed an interest in supporting our business development, although we have not entered into any agreements for additional financing with these institutions. However, our ability to obtain adequate financing to satisfy our capital expenditure and debt service requirements may be limited by our financial condition and results of operations and the liquidity of international and domestic financial markets, including the following factors:

- Any failure by us to achieve timely rollover, extension or refinancing of our short-term debt may result in our inability to meet our obligations in connection with debt service, accounts payable and/or other liabilities when they become due and payable.

- Our primary operating subsidiary is a PRC incorporated company. Therefore, prior to accessing the international capital markets we will be subject to limitations imposed by various PRC government authorities, including the State Administration for Foreign Exchange, depending on the type of international financing raised. We may also need to obtain PRC government support for any project involving significant capital investment in the operations of our PRC subsidiary.

- In addition, financing sources often look to similarly situated entities when determining whether, and at what rates, to provide financing. Successful or unsuccessful financing by Hong Kong and PRC entities similarly situated to us could have an impact on our ability to obtain external financing.

See "Item 3--Key Information--Risk Factors--Risks relating to our business--Our future prospects largely depend on our capital expenditure plans, which are subject to various risks" and "--We may not be able to obtain external financing that is acceptable to us for business development purposes."

Employee Benefits

When we became a separate entity as a result of CNOOC's reorganization in October 1999, CNOOC retained all liabilities for retirement benefits for its employees, both former and current, who had not been transferred to us. As compensation for CNOOC's retention of liabilities for retirement benefits payable to approximately 7,000 retired CNOOC employees who were previously engaged in the oil and gas business that was transferred to us in the reorganization, we made a one-time payment to CNOOC of Rmb 1,660.0 million in 2001.

All of our full-time employees in the PRC are covered by a government-regulated pension plan and are entitled to an annual pension at their retirement dates. The PRC government is responsible for the pension liabilities to these retired employees under this government pension plan. The actual pension payable to each retiree is subject to a formula based on the status of the individual pension account, general salary and inflation movements. We are required to make annual contributions to the government pension plan at rates ranging from 9% to 22% of our employees' salaries. The related pension costs are expensed as incurred.

The expenses attributable to mandatory contributions under the current government pension plan are included in our historical consolidated statements of income under either operating expenses for our production staff or selling and administrative expenses for our administrative staff. We expect that, under the current PRC rules and regulations regarding employee retirement benefits, the future costs of the current government plan will be comparable to our historical costs, subject to customary increases largely in line with salary increases of our employees.

We are required to make contributions to a mandatory provident fund at a rate of 5% of the base salaries for full-time employees in Hong Kong. The costs are expensed as incurred.

Our Indonesian subsidiaries employ approximately 900 employees, including approximately 50 expatriates. We provide benefits to expatriates that we believe to be in line with customary international practices. Our local staff in Indonesia enjoy welfare benefits mandated by Indonesia labor laws.

Holding Company Structure

We are a holding company. Our entire petroleum exploration, development, production and sales business in the PRC is owned and conducted by CNOOC China Limited, our wholly foreign-owned enterprise in the PRC. Our entire petroleum exploration, development and production business outside the PRC is owned and conducted by CNOOC International Limited, our wholly-owned subsidiary

incorporated in the British Virgin Islands. International sales of crude oil are conducted by China Offshore Oil (Singapore) International Pte. Ltd., our wholly-owned subsidiary incorporated in Singapore. Accordingly, our future cash flows will consist principally of dividends from our subsidiaries. The subsidiaries' ability to pay dividends to us is subject to various restrictions, including legal restrictions in their jurisdictions of incorporation. For example, legal restrictions in the PRC permit payment of dividends only out of net income determined in accordance with PRC accounting standards and regulations. In addition, under PRC law, CNOOC China Limited is required to set aside a portion of its net income each year to fund certain reserve funds. These reserves are not distributable as cash dividends.

Inflation/Deflation

According to the China Statistical Bureau, China experienced an overall national deflation rate, as represented by the general consumer price index, of 1.2% in 2003, an overall inflation rate of 3.9% in 2004 and an overall inflation rate of 1.8% in 2005. Neither the deflation nor the inflation has had a significant impact on our results of operations in the respective years.

U.S. GAAP Reconciliation

Our consolidated financial statements are prepared in accordance with Hong Kong GAAP, which differ in certain material respects from U.S. GAAP. These differences relate primarily to the treatment of impairment of long-lived assets and the treatment for convertible bonds. For differences between Hong Kong GAAP and U.S. GAAP that affect our net income or shareholders' equity. Please refer to note 38 to our consolidated financial statements attached to this annual report.

Taxation

We are subject to income taxes on an entity basis on income arising in or derived from the tax jurisdictions in which we and each of our subsidiaries are domiciled and operate. We are not liable for income taxes in Hong Kong as we currently do not have any assessable income from Hong Kong sources. Pursuant to a notice issued by the State Administration of Taxation in March 2001, we are entitled to all tax benefits conferred by Chinese law on foreign invested enterprises.

Our PRC subsidiary, absent exemptions, is subject to enterprise income tax at the rate of 33%. Following the October 1999 reorganization, our PRC subsidiary became a wholly foreign owned enterprise and accordingly was exempted from 3% local surcharges, reducing its enterprise income tax rate to the current rate of 30%. The PRC enterprise income tax is levied based on taxable income including income from operations as well as other components of earnings, as determined in accordance with the generally accepted accounting principles in the PRC, or PRC GAAP. Besides income taxes, our PRC subsidiary also pays certain other taxes, including:

- production taxes equal to 5% of independent production and production under production sharing contracts; and
- business tax of 5% on other income.

Our subsidiary in Singapore, China Offshore Oil (Singapore) International Pte. Ltd., is subject to income tax at the rate of 10% and 20% for its oil trading activities and other income-generating activities, respectively. Our subsidiaries that own interests in oil properties in Indonesia along the Malacca Strait are subject to corporate and branch profit tax of 44%. The nine subsidiaries of Repsol-YPF, S.A. in Indonesia acquired by us during 2002 are all subject to corporate and dividend tax at rates ranging from 43.125% to 51.875%. None of our other subsidiaries were subject to any income taxes in their respective jurisdictions for the years presented.

We calculate deferred taxation to account for temporary differences between our tax bases, which is used for income tax reporting and prepared in accordance with applicable tax guidelines, and our accounting bases, which is prepared in accordance with applicable financial reporting requirements. Major temporary differences include accelerated amortization allowances for oil and gas properties,

which are offset in part by provision for dismantlement and a provision for impairment of property, plant and equipment and write-off of unsuccessful exploratory drilling. As of December 31, 2003, 2004 and 2005, we had Rmb 5,783.2 million, Rmb 6,688.5 million and Rmb 6,827.9 million (US$846.1 million), respectively, in net deferred tax liabilities. See note 13 to our consolidated financial statements attached to this annual report.

Change of Accountants

On June 6, 2002, we terminated the engagement of Arthur Andersen & Co as our independent public accountants. Prior to such date, Arthur Andersen had audited our consolidated financial statements, including financial statements as of and for the year ended December 31, 2001 presented in "Item 3--Selected Financial Data." On June 15, 2002, Arthur Andersen was convicted of federal obstruction of justice charges in connection with the U.S. government's investigation of Enron Corporation. On August 31, 2002, Arthur Andersen voluntarily relinquished its licenses to practice public accountancy in all states of the United States and, accordingly, cannot furnish any written consent to the issue of this annual report with the inclusion of its reports in the form and context in which they are included. For a discussion of risks related to Arthur Andersen, see "Item 3--Key Information--Risk Factors--Risks relating to our business--You may not be able to assert claims against Arthur Andersen, our independent public accountants for periods prior to 2002, nor may you be able to assert claims against our current independent public accountants for financial statements previously audited by Arthur Andersen."

On June 6, 2002, we appointed Ernst & Young as our independent accountants. Ernst & Young audited our consolidated financial statements for the year period ended December 31, 2003, 2004 and 2005 included in this annual report.

Impact of Recently Issued Accounting Standards

U.S. GAAP

In December 2004, the Financial Accounting standards Board ("FASB"), issued SFAS No. 153, "Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29". This Statement, which addresses the measurement of exchanges of non-monetary assets, is effective prospectively for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this Statement is not expected to impact our consolidated financial position or results of operations.

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Share-Based Payment" (FAS No.123R), which replaces FAS No. 123 and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." FAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim period after June 15, 2005, with early adoption encouraged. Under the SEC's rules, FAS No. 123R is effective for us beginning January 1, 2006. The pro forma disclosures previously permitted under FAS No. 123 are no longer an alternative to financial statement recognition. We believe the adoption of the FAS No. 123R will have no material impact on our consolidated financial position or results of operations as we currently account for the stock options under the fair value recognition provision of FAS No. 123.

In 2005, the FASB has finalized an amendment to Statement No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" (FAS No. 19) that change the way oil and gas producers account for deferred exploratory drilling costs. The new standard would relax the one-year limitation, so long as oil and gas reserves have been discovered and an enterprise "is making sufficient progress assessing the reserves and the economic and operating viability of the project." We believe the adoption of amendment to FAS No. 19 will have no material impact on our consolidated financial position or results of operations. This amendment is effective for the first reporting period beginning after April 4, 2005.

In March 2005, the FASB issued FASB Interpretation Number 47 (FIN No. 47), "Accounting for Conditional Asset Retirement Obligations". The interpretation clarifies the requirement to record

abandonment liabilities arising from legal obligations when the asset retirement depends on a conditional future event. FIN No. 47 requires that the uncertainty about the timing or method of settlement of a conditional asset retirement obligation be factored into the measurement of the liability when sufficient information available. FIN No. 47 is effective for fiscal years ending after December 15, 2005 and application of the interpretation did not change our calculation of abandonment obligations.

In May 2005, the FASB issued SFAS No.154, iss.Accounting Changes and Error Corrections,i