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CNOOC LTD  
Form 20-F/A  
September 07, 2005

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

FORM 20-F/A  
(AMENDMENT NO. 1)

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934  
OR
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2004  
OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-14966

CNOOC LIMITED  
[Chinese Characters 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 exchange o -----
American depository shares, each representing 100 shares of par value HK\$0.02 per share.....	New York Stock Exchange
Shares of par value HK\$0.02 per share.....	New York Stock Exchange

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. Non  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common

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close of the period covered by the annual report.

Shares, par value HK\$0.02 per share.....4

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  No

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

Item 17  Item 18

\* A 5-for-1 stock split went into effect on March 17, 2004 and since then each American depositary share represents 100 shares. The number of shares outstanding immediately after the stock split was 41,070,828,275. Due to buybacks by the registrant and the exercise of certain share options by its employee, the number of shares outstanding on June 8, 2005 was 41,054,675,375. \*\* Not for trading, but only in connection with the registration of American depositary shares.

EXPLANATORY NOTE

This Annual Report on Form 20-F/A, or this Form 20-F/A, is being filed by CNOOC Limited as Amendment No. 1 to its Annual Report on Form 20-F for the fiscal year ended December 31, 2004 filed on June 22, 2005, or the Original Form 20-F. This Form 20-F/A amends the Original Form 20-F in three aspects:

- o To delete all presentations of "present value of estimated future net reserves before income taxes (discounted at 10%),"
o To delete all presentations related to the non-GAAP financial measure of "EBITDE," and
o To confirm the effectiveness of its disclosure controls and procedures.

Except for the amendments outlined above, this Form 20-F/A, dated as of the date of the Original Form 20-F, does not change or update the disclosures set forth in the Original Form 20-F and does not reflect events occurring after the filing of the Original Form 20-F.

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## Table of Contents

TERMS AND CONVENTIONS.....	
FORWARD-LOOKING STATEMENTS.....	

### PART I

ITEM 1.	IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS.....
ITEM 2.	OFFER STATISTICS AND EXPECTED TIMETABLE.....
ITEM 3.	KEY INFORMATION.....
	A. Selected Financial Data.....
	B. Capitalization and Indebtedness.....
	C. Reasons for the Offer and Use of Proceeds.....
	D. Risk Factors.....
ITEM 4.	INFORMATION ON THE COMPANY.....
	A. History and Development.....
	B. Business Overview.....
ITEM 5.	OPERATING AND FINANCIAL REVIEW AND PROSPECTS.....
	A. Operating Results.....
	B. Liquidity and Capital Resources.....
	C. Research and Development, Patents and Licenses, etc.....
	D. Trend Information.....
	E. Off-Balance Sheet Arrangements.....
	F. Tabular Disclosure of Contractual Obligations.....
ITEM 6.	DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.....
	A. Directors and Senior Management.....
	B. Compensation of Directors and Officers.....
	C. Board Practice.....
	D. Employees.....
	E. Share Ownership.....
ITEM 7.	MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS.....
	A. Major Shareholders.....
	B. Related Party Transactions.....
	C. Interests of Experts and Counsel.....
ITEM 8.	FINANCIAL INFORMATION.....
	A. Consolidated Statements and Other Financial Information.....
	B. Significant Changes.....
ITEM 9.	THE OFFER AND LISTING.....
ITEM 10.	ADDITIONAL INFORMATION.....
	A. Share Capital.....
	B. Memorandum and Articles of Association.....
	C. Material Contracts.....
	D. Exchange Controls.....
	E. Taxation.....
	F. Dividends and Paying Agents.....
	G. Statement by Experts.....
	H. Documents on Display.....
	I. Subsidiary Information.....
ITEM 11.	QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK.....
ITEM 12.	DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.....

### PART II

ITEM 13.	DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES.....
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ITEM 14.	MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS.....
	A. Material Modifications to the Rights to Security Holders.....
	B. Use of Proceeds.....
ITEM 15.	CONTROLS AND PROCEDURES.....
ITEM 16A.	AUDIT COMMITTEE FINANCIAL EXPERT.....
ITEM 16B.	CODE OF ETHICS.....
ITEM 16C.	PRINCIPAL ACCOUNTANT FEES AND SERVICES.....
ITEM 16D.	EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.....
ITEM 16E.	PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.....

PART III

ITEM 17.	FINANCIAL STATEMENTS.....
ITEM 18.	FINANCIAL STATEMENTS.....
ITEM 19.	EXHIBITS.....

TERMS AND CONVENTIONS

Definitions

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

- o "CNOOC" are to our controlling shareholder, China National Offshore Oil Corporation, a PRC state-owned enterprise, and its affiliates, excluding us and our subsidiaries;
- o "CNOOC Limited," "our company," "we," "our" or "us" are to CNOOC Limited, a Hong Kong limited liability company and the registrant of this annual report, and its subsidiaries;
- o "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;
- o "Hong Kong Stock Exchange" or "HKSE" are to The Stock Exchange of Hong Kong Limited;
- o "HK\$" are to Hong Kong dollar, the legal currency of the Hong Kong Special Administrative Region;
- o "JPY" are to Japanese yen, the legal currency of Japan;
- o "Rmb" are to Renminbi, the legal currency of the PRC;

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- o "Rupiah" are to Indonesian Rupiah, the legal currency of the Republic of Indonesia; and
- o "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 31, 2004 of US\$1.00=Rmb 8.2765. 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, 2004. 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, 2004, 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:

- o 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:
- o 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; and (iii) the volume of oil and gas sales for the applicable period from our overseas interests.

1

Our "net proved reserves" are derived from proved reserves less certain adjustments, where:

- o proved reserves is equal to the sum of (i) our 100% interest in our independent oil and gas properties (excluding the proved reserves attributable to our associated company); (ii) our participating interest in the properties covered under our production sharing contracts in the PRC and overseas; and (iii) our 30% interest in the proved reserves of our associated company; while:
- o the adjustments equal the sum of (i) an adjustment for our share of royalties payable to the PRC government and our participating interest in share oil payable to the PRC government under our production sharing contracts in the PRC; (ii) an adjustment for production allocable to foreign partners under our production

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sharing contracts in the PRC as reimbursement for exploration expenses attributable to our working interest; and (iii) adjustments for share oil payable under our overseas production sharing contracts for any domestic market obligation under which the contractor must sell a specified percentage of its crude oil to the local overseas market (such as in Indonesia) at a reduced price. 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:

- o "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.
- o "appraisal well" means an exploration well drilled after a successful wildcat well to gain more information on a newly discovered oil or gas reserve.
- o "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.
- o "crude oil" means crude oil and liquids, including condensate, natural gas liquids and liquefied petroleum gas.
- o "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.
- o "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.
- o "exploration well" means a wildcat or appraisal well.

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- o "finding and development cost per BOE" means, for a given period, the sum of total finding and development cost incurred, divided by the sum of discoveries, extensions, purchases of reserves, and revisions of prior estimates of net proved reserves.
- o "finding cost" means, for a given period, costs incurred in identifying areas that may warrant examination and in examining specific areas that are considered to have prospects of containing oil and gas reserves, including costs of drilling exploration wells.
- o "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.
- o "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.
- o "net wells" means a party's working interest in wells under a production sharing contract.
- o "offshore" means areas under water with a depth of five meters or greater.
- o "onshore" means areas of land and areas under water with a depth of less than five meters.
- o "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.
- o "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.
- o "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:

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

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structures for exploratory purposes to predict the location of undiscovered reserves.

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

3

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

### References to:

- o bbls means barrels, which is equivalent to approximately 0.134 tons of oil (33 degrees API);
- o mmbbls means million barrels;
- o BOE means barrels-of-oil equivalent;
- o BOE per day means barrels-of-oil equivalent per day;
- o million BOE means million barrels-of-oil equivalent;
- o mcf means thousand cubic feet;
- o mmcf means million cubic feet;
- o bcf means billion cubic feet, which is equivalent to approximately 283.2 million cubic meters;
- o BTU means British Thermal Unit, a universal measurement of energy; and
- o km means kilometers, which is equivalent to approximately 0.62 miles.

4

### 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



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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:

- o the amount and nature of future exploration, development and other capital expenditures,
- o wells to be drilled or reworked,
- o oil and gas prices and demand,
- o future earnings and cash flow,
- o development projects,
- o exploration prospects,
- o estimates of proved oil and gas reserves,
- o potential reserves,
- o development and drilling potential,
- o drilling prospects,
- o expansion and other development trends of the oil and gas industry,
- o business strategy,
- o production of oil and gas,
- o development of undeveloped reserves,
- o expansion and growth of our business and operations, and
- o 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 you 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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## 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. The following selected income statement data and cash flows data for the three years ended December 31, 2002, 2003 and 2004 and the selected balance sheet data as of December 31, 2003 and 2004 have been derived from our consolidated financial statements audited by Ernst & Young, our current independent public accountants. The following selected income statement data and cash flows data for the two years ended December 31, 2000 and 2001 and the selected balance sheet data as of December 31, 2000 and 2001 have been derived from our consolidated financial statements audited by Arthur Andersen & Co, our independent public accountants prior to 2002.

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."

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 31			
2000	2001	2002	2003
Rmb	Rmb	Rmb	Rmb

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(in millions, except per share and

Income Statement Data:

Hong Kong GAAP

Operating revenues:

Oil and gas sales.....	18,819	17,561	23,779	28,117
Marketing revenues.....	5,126	2,537	2,377	12,399
Other income.....	279	722	217	434
	-----	-----	-----	-----
Total operating revenues.....	24,224	20,820	26,374	40,950
	-----	-----	-----	-----

Expenses:

Operating expenses.....	(2,124)	(2,329)	(3,775)	(4,513)
Production taxes.....	(1,037)	(884)	(1,023)	(1,239)
Exploration expenses.....	(553)	(1,039)	(1,318)	(848)
Depreciation, depletion and amortization.....	(2,578)	(2,567)	(4,020)	(4,643)
Dismantlement.....	(104)	(90)	(126)	(167)
Crude oil and product purchases.....	(5,098)	(2,453)	(2,326)	(12,295)
Selling and administrative expenses.....	(456)	(616)	(1,007)	(1,213)
Others.....	(217)	(618)	(31)	(350)
	-----	-----	-----	-----
	(12,167)	(10,596)	(13,626)	(25,268)
	-----	-----	-----	-----

Interest income.....	237	318	148	184
Interest expenses.....	(475)	(117)	(295)	(355)
Exchange gains (losses), net.....	381	235	(114)	(7)
Short term investment income.....	--	221	193	124
Share of profits of associates.....	218	90	165	220
Non-operating income (expenses), net.....	(195)	35	(71)	315
	-----	-----	-----	-----

Income before tax.....	12,223	11,006	12,774	16,163
Tax.....	(1,926)	(3,048)	(3,541)	(4,628)
	-----	-----	-----	-----
Net income.....	10,297	7,958	9,233	11,535
	=====	=====	=====	=====

Net income per share (basic) (a) (b).....	0.33	0.20	0.22	0.28
Net income per share (diluted) (a) (c).....	0.33	0.20	0.22	0.28
Net income per ADS (basic) (a) (b).....	32.53	20.04	22.48	28.09
Net income per ADS (diluted) (a) (c).....	32.53	20.04	22.47	28.06

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).....	0.196	0.032	0.032	0.026
Proposed final (in US\$) (d).....	0.024	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.....	18,819	17,561	23,779	28,117
Marketing revenues.....	5,126	2,537	2,377	12,399
Other income.....	279	722	217	434

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Total operating revenues.....	24,224	20,820	26,374	40,950
Net Income.....	10,302	7,920	9,086	11,980
Net income per share (basic) (a) (b).....	0.33	0.20	0.22	0.29
Net income per share (diluted) (a) (c).....	0.33	0.20	0.22	0.29
Net income per ADS (basic) (a) (b).....	32.53	19.95	22.12	29.17

7

	Year ended December 31			
	2000	2001	2002	2003
	Rmb	Rmb	Rmb	Rmb
	(in millions, except per share and			
Net income per ADS (diluted) (a) (c).....	32.55	19.95	22.13	29.14

(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 2000 have been computed by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 31,655,572,105 and 316,555,721 respectively (based on a ratio of 100 shares to one ADS) for the period. Similarly, 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

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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, 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.

- (c) Net income per share (diluted) and net income per ADS (diluted) for 2000 have been computed by dividing net income by the weighted average number of shares and the weighted average number of ADSs of 31,655,572,105 and 316,555,721 respectively (based on a ratio of 100 shares to one ADS) for the period. Similarly, 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.
- (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.

	As of December 31,			
	2000	2001	2002	2003
	Rmb	Rmb	Rmb	Rmb
	(in millions)			
Balance Sheet Data:				
Hong Kong GAAP				
Cash and cash equivalents.....	2,797	6,394	7,839	14,400
Time deposits with maturities over three months...	3,425	2,050	4,690	2,323
Short term investments.....	300	8,896	6,531	5,684
Current assets.....	9,472	20,030	24,487	29,263
Property, plant and equipment, net.....	22,654	23,828	36,072	43,124
Investment in associates.....	471	462	537	1,118
Total assets.....	32,597	44,320	61,096	73,504
Current liabilities.....	8,768	4,392	7,134	9,307
Long term bank loans, net of current portion.....	4,749	3,256	941	890
Long term guaranteed notes .....	--	--	4,071	8,142
Total long term liabilities.....	7,707	6,617	13,393	17,461
Total liabilities.....	16,475	11,009	20,527	26,768
Shareholders' equity.....	16,122	33,311	40,568	46,737

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U.S. GAAP				
Total assets.....	32,330	44,062	60,444	73,234
Total long term liabilities.....	7,707	6,617	13,393	17,461
Shareholders' equity.....	15,855	33,053	40,344	46,496

8

	Year ended December 31			
	2000	2001	2002	2003
	Rmb	Rmb	Rmb	Rmb
	(in millions, except percentage)			
Other Financial Data:				
Hong Kong GAAP				
Capital expenditures paid.....	4,404	4,343	6,833	8,272
Cash provided by (used for):				
Operating activities.....	13,233	11,759	14,742	17,819
Investing activities.....	(7,861)	(11,366)	(11,724)	(9,513)
Financing activities.....	(3,454)	3,204	(1,573)	(1,745)
Ratio of total debt to total capitalization(1).....	27.5%	12.3%	11.6%	16.2%
U.S. GAAP				
Cash provided by (used for):				
Operating activities.....	13,233	11,759	14,742	17,819
Investing activities.....	(7,861)	(11,366)	(11,724)	(9,513)
Financing activities.....	(3,454)	3,204	(1,573)	(1,745)
Ratio of cash provided by operating activities to gross interest expense(2).....	27.9x	37.2x	36.4x	35.1x
Ratio of total debt to cash provided by operating activities.....	0.4x	0.4x	0.4x	0.5x
Net income.....	10,302	7,920	9,086	11,980
Net income margin(3).....	42.5%	38.0%	34.5%	29.3%
Ratio of net income to gross interest expense(2)..	21.7x	25.1x	22.4x	23.6x
Ratio of total debt to net income.....	0.6x	0.6x	0.6x	0.8x
Ratio of total debt to total capitalization(1).....	27.9%	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.

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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 8.2765 to US\$1.00, the noon buying rate as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2004. 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:

Period -----	End ----	Noon Buying Rate -----		L -----
		Average (1) -----	High -----	
		(Rmb per US\$1.00)		
2000.....	8.2774	8.2784	8.2799	8.
2001.....	8.2766	8.2772	8.2786	8.
2002.....	8.2800	8.2772	8.2800	8.
2003.....	8.2767	8.2771	8.2800	8.
2004.....	8.2765	8.2768	8.2774	8.
December 2004.....	8.2765	--	8.2767	8.
January 2005.....	8.2765	--	8.2765	8.
February 2005.....	8.2765	--	8.2765	8.
March 2005.....	8.2765	--	8.2765	8.
April 2005.....	8.2765	--	8.2765	8.
May 2005.....	8.2765	--	8.2765	8.

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

As of June 8, 2005, the noon buying rate for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York was Rmb 8.2765 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 at the rate of HK\$7.80 to US\$1.00. 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 you 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.

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Period -----	End ----	Noon Buying Rate -----		Low ----
		Average (1) -----	High -----	
		(HK\$ per US\$1.00)		
2000.....	7.7999	7.7936	7.8008	7.77
2001.....	7.7980	7.7996	7.8004	7.79
2002.....	7.7988	7.7996	7.8095	7.79
2003.....	7.7640	7.7864	7.8001	7.72
2004.....	7.7723	7.7891	7.8010	7.76
December 2004.....	7.7723	--	7.7821	7.76
January 2005.....	7.7993	--	7.7994	7.77
February 2005.....	7.7992	--	7.7999	7.79
March 2005.....	7.7990	--	7.7998	7.79
April 2005.....	7.7946	--	7.7995	7.79
May 2005.....	7.7788	--	7.7995	7.77

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

As of June 8, 2005, 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\$7.7802 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:

- o political developments in petroleum producing regions;
- o 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 regulation;
- o weather conditions; and
- o overall economic conditions.

Our revenues and net income have fluctuated significantly in the past five years, principally due to the volatility of world oil prices. In 2004, oil prices for West Texas Intermediate, the international benchmark for crude oil, rose 33.6% from US\$32.52 per barrel on January 1, 2004 to US\$43.45 per barrel on December 31, 2004. The conflict and turmoil in Iraq and the Mid-East in 2003 and 2004 raised concerns about the security and availability of ample supplies to meet growing global demand. West Texas Intermediate reached a high in 2004 of US\$56.17 per barrel on October 22, 2004 and was US\$52.54 per barrel on June 8, 2005. 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 in the PRC market are determined by negotiations between us and the prospective buyers. Our typical contracts with gas buyers include provisions for annual 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 in decreased earnings or 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 consistency in the PRC and Indonesian governments' royalty and share oil policies.

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."

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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.

11

Approximately 51.6% of our proved reserves were undeveloped as of December 31, 2004. 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\$1,844.8 million to develop our oil and gas properties and US\$220.9 million for exploration in 2005. 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:

- o our ability to generate sufficient cash flows from operations to finance our capital expenditures, investments and other requirements;
- o the availability and terms of external financing;
- o changes in crude oil and natural gas prices, which may affect cash flows from operations and capital expenditure and investment plans;
- o the mix of exploration and development activities conducted on an independent basis and under production sharing contracts;
- o new investment opportunities that may be presented to us, including international investment opportunities and liquefied and other natural gas projects;
- o approvals required from overseas governments for certain capital expenditures and investments outside the PRC;
- o our ability to obtain sufficient foreign currency to finance our capital expenditures; and
- o economic, political and other conditions in the PRC and in overseas countries where we have operations.

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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:

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

12

- o 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 gasfields located in the western part of China to the eastern coastal regions;
- o our new natural gas activities may subject us to additional government regulation in China and overseas countries;
- o 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 overseas countries as a result of our acquisition of oil and gas interests located in these regions;"
- o 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
- o 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

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pipelines and other infrastructure depends on many factors, many of which are beyond our control, such as government 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 70.64% of our shares as of June 8, 2005. 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 CNOOC Offshore Oil Engineering Company Limited. For the year ended December 31, 2004, sales to CNOOC and its affiliates accounted for 25.3% 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. 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.

13

Under current PRC law, CNOOC has the exclusive right to enter into production sharing contracts with international 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 interest, 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, 2002, 2003 and 2004, sales to CNOOC and its affiliates accounted for 16.5%, 20.3% and 25.3%, respectively, of our total operating revenues, while sales to Sinopec accounted for 26.1%, 17.0% and 19.3%, respectively, of our total operating revenues. CNOOC has a controlling interest in us. However, our transactions with CNOOC and its affiliates are on commercial

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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 international 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 this 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

14

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:

- o weather conditions;

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- o natural disasters;
- o equipment shortages and delays; and
- o 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 overseas countries 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 overseas operations and assets in Indonesia, Australia, Canada, Morocco and Myanmar, and 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 you that the operations and assets that we currently have or in the future may have in overseas countries 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 overseas countries 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 overseas countries, including Indonesia, Australia, Canada, Morocco 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, including those relating to the development, production, marketing, pricing, transportation and storage of natural gas and crude oil, 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

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exchange and repatriation restrictions, changing political conditions, foreign exchange rate fluctuations and currency controls.

15

The Tangguh LNG project is a greenfield project and may not be successful

In January 2003, we paid approximately US\$275 million to acquire the equivalent of a 12.5% equity interest in the Tangguh LNG project in Indonesia. In May 2004, we acquired from British Gas International Limited a 20.767% interest in Muturi production sharing contract offshore Indonesia for a consideration of US\$105.1 million. As a result, our interest in Muturi production sharing contract increased to 64.767% and our interest in the Tangguh LNG project increased to 16.96%. The Tangguh LNG project is a greenfield project with a limited operational track record, and is subject to risks associated with attaining government approvals, delays in the development of LNG facilities required to process gas, and lower than expected demand for gas reserves from this project. The partners in the Tangguh LNG project have entered into a 25-year supply contract to provide up to 2.6 million tonnes of liquefied natural gas per year to a liquefied natural gas terminal being developed by CNOOC and its partners in Fujian Province of China and a 20-year supply contract to provide up to 1.35 million tonnes of liquefied natural gas per year to two South Korean companies, SK Power Company Limited and POSCO. The expected time to begin supplying liquefied natural gas under these two supply contracts is 2008 and 2005, respectively. The Tangguh LNG partners have also signed contracts to provide liquefied natural gas to North America. These contracts, however, may not be sufficient to make the project commercially viable. We cannot assure you that the parties to the Tangguh LNG project will be able to secure additional contracts to make the project commercially viable. For further details of our investment in the Tangguh LNG project, see "Item 4--Information on the Company--Business Overview--Natural Gas Business--Overseas Activity."

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

From time to time, we must secure 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:

- o our results of operations, financial condition and cash flows;
- o the amount of capital that other PRC and Hong Kong entities may seek to raise in the international capital markets;
- o economic, political and other conditions in the PRC and Hong Kong;
- o the PRC government's policies relating to foreign currency borrowings; and
- o 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

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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 you 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

16

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 years ended, and as of, December 31, 2000 and 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, exports and allocation of various resources. Since March 2003, the PRC government has undergone substantial organizational reforms. We cannot assure you that the legal regime affecting our businesses will remain substantially unchanged. As of the date of this annual report, the National Development and Reform Commission has become the primary coordinator for the petroleum industry and, together with other relevant governmental agencies, provides regulatory supervision over the petroleum industry. Prior to March 2003, the primary coordinator for the petroleum industry was the State Economic and Trade Commission, which has been merged partly into the National Development and Reform Commission, partly into the Ministry of Commerce and partly into the State-owned Assets Supervision and Administration Commission.

In the past, we have benefited from various favorable PRC government policies, laws and regulations that were enacted to encourage the development



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of the offshore petroleum industry. See "Item 4--Information on the Company--Regulatory Framework--Special Policies Applicable to the Offshore Petroleum Industry in China." However, there can be no assurance that the PRC government will continue existing policies or that it will not adopt new policies, laws or regulations.

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."

Increased 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 and liquefied petroleum gas and the subsequent lifting

17

of the restrictions on distribution of crude and processed oil in accordance with China's WTO commitments will 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:

- o impose fees for the discharge of waste substances;
- o require the payment of fines and damages for serious environmental pollution; and
- o 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

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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:

- o government investment;
- o level of development;
- o control of capital investment;
- o control of foreign exchange; and
- o 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 in the past 25 years, but the growth has been uneven both geographically and among various sectors of the economy. Economic growth has also been accompanied by periods of high inflation. 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.

18

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:

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

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- o 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 exchange rate may become volatile and the Renminbi may be devalued against the Hong Kong dollar, U.S. dollar or other currencies, or the Renminbi may be permitted to enter into full or limited free float, which may result in an appreciation in the value of the Renminbi against the Hong Kong and U.S. dollars, any of which could have an uncertain effect on our business and operating results.

In 2003, we prepaid most of our loans denominated in Japanese yen. We also hedged the balance of these loans through currency swaps. 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 business is 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 reach 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

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prior court decisions may be cited as persuasive authority 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 ADSs and shares. As of June 8, 2005, CNOOC, through its wholly owned subsidiaries, CNOOC (BVI) Limited and Overseas Oil & Gas Corporation Ltd., held approximately 70.64% of our shares and the rest of our shares were held by public investors, including institutional and corporate investors. As of June 8, 2005, neither CNOOC (BVI) Limited nor Overseas Oil & Gas Corporation Ltd. had sold any of their holdings of our shares. 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 performed both commercial and administrative functions relating to exploration and development offshore China, including:

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- o 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;

20

- o organizing international bidding for offshore petroleum exploitation;
- o conducting independent exploration, development, production and sales activities in independently operated oil and gas fields offshore China;
- o awarding projects to and signing bilateral contracts with foreign partners for offshore petroleum exploitation;
- o reviewing and confirming appraisal reports and overall development plans required under production sharing contracts; and
- o 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 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:

- o 37 production sharing contracts and one geophysical survey agreement;
- o eight independent development and production projects;
- o a 30% interest in Shanghai Petroleum and Natural Gas Company Limited;
- o the land use rights to terminal facilities in Nanhai, Weizhou and the western part of the Bohai Bay; and
- o 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:

- o a petrochemical project in Huizhou, Guangdong Province;

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- o a fertilizer plant in Hainan Province; and
- o a liquefied natural gas project in Guangdong.

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

- o organizing international bidding for offshore petroleum exploitation;
- o awarding projects to and signing bilateral contracts with foreign partners for offshore petroleum exploitation;
- o approving any extension of the period for the completion of the appraisal work on petroleum discovery under the production sharing contracts; and

21

- o 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 the PRC offshore oil and natural gas;
- 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.

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The undertakings from CNOOC will cease to have any effect:

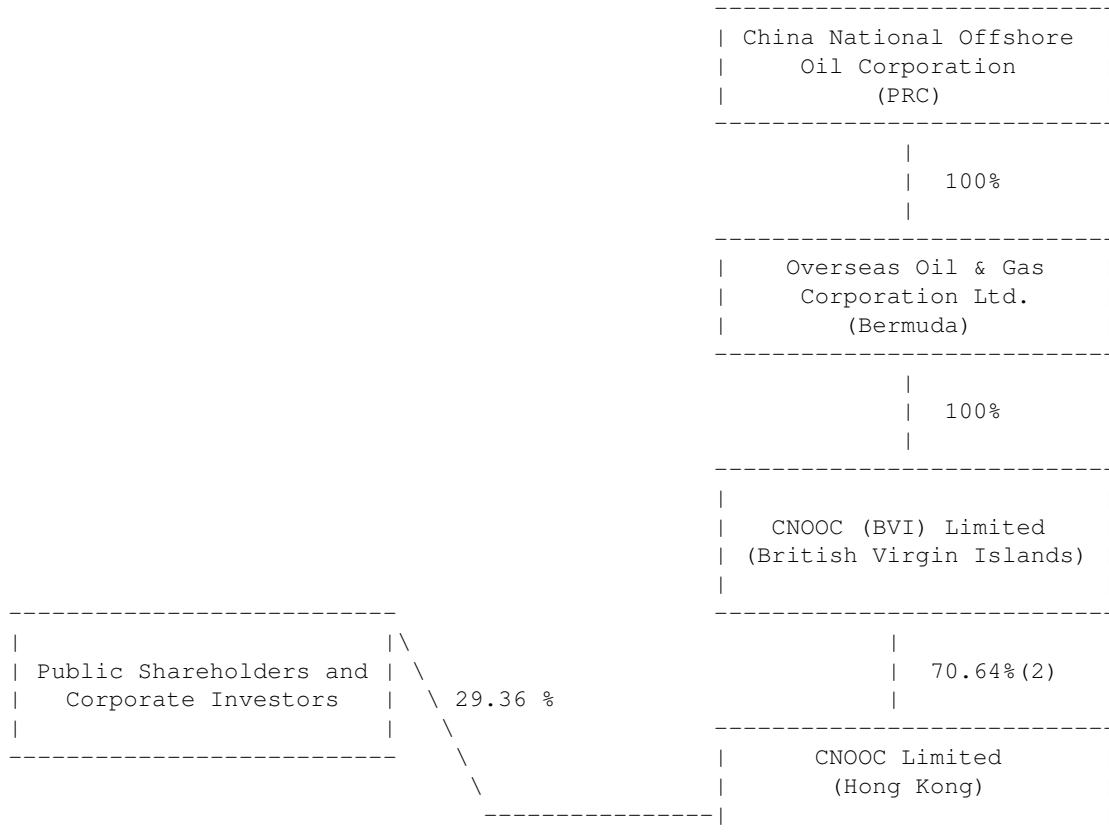
- o if we become a wholly owned subsidiary of CNOOC;
- o if our securities cease to be listed on any stock exchange or automated trading system; or
- o 12 months after CNOOC or any other PRC government-controlled entity ceases to be our controlling shareholder.

### Corporate Structure

CNOOC indirectly owned or controlled an aggregate of approximately 70.64% of our shares as of June 8, 2005. 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.

22

The following chart sets forth our controlling entities and our principal subsidiaries as of June 8, 2005.



100% 	100% 	100% 
CNOOC   International   Limited(3)   (British Virgin Islands)	CNOOC China   Limited(4)   (PRC)	China Offshore Oil   (Singapore)   International Pte. Ltd.   (Singapore)

- (1) Overseas Oil & Gas Corporation Ltd. also directly owns five shares of our company.
- (2) In 2004, we repurchased a total of 18,453,000 shares in the open market based on the general mandates approved by our shareholders on May 29, 2003 and June 14, 2004. The repurchased shares have been cancelled. Due to the decrease of our total issued and outstanding shares, CNOOC (BVI) Limited's interest in us increased from 70.61% to 70.64%. For further details about our share buybacks, see "Item 16E--Purchases of Equity Securities by the Issuer and Affiliated Purchasers."
- (3) Owner of our overseas interests in petroleum exploration and production businesses and operations.
- (4) Owner of substantially all of our PRC petroleum exploration and production businesses, operations and properties.
- (5) Business vehicle through which we engage in sales and marketing activities in the international markets.
- (6) 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 2002, 2003 and 2004 amounted to Rmb 11,566.9 million, Rmb 12,372.5 million and Rmb 18,622.0 million (US\$2,250.0 million), respectively. For 2005, we have budgeted approximately US\$3.1 billion for capital expenditures, approximately US\$220.9 million of which is budgeted for general exploration activities offshore China and approximately US\$1,624.8 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."



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### 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 international oil and gas companies offshore China. As of December 31, 2004, we had estimated net proved reserves of 2,230.0 million BOE, comprised of 1,455.6 million barrels of crude oil and condensate and 4,646.6 billion cubic feet of natural gas. For the year 2004, our net production averaged 319,436 barrels per day of crude oil, condensate and natural gas liquids and 364.1 million cubic feet per day of natural gas, which together totaled 382,513 BOE per day.

Our net proved reserves increased from 1,757.4 million BOE as of December 31, 2000 to 2,230.0 million BOE as of December 31, 2004 which represents a compound annual growth rate of 6.1%. 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, 2004, approximately 51.6% of our net proved reserves were classified as net proved undeveloped. We plan to spend US\$1,624.8 million developing our reserves primarily offshore China and US\$220.9 million for exploration primarily offshore China in 2005.

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, 2004, independent properties accounted for 61.0% of our total net proved reserves and independent net proved undeveloped reserves accounted for 64.7% of our total net proved undeveloped reserves. We are the operator of all of our independent producing properties. For the year ended December 31, 2004, production from our independent properties accounted for 43.9% 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, 2004, we had approximately 25 foreign partners under our existing production sharing contracts offshore China, all of which are international oil and gas companies, including BP, ChevronTexaco, ConocoPhillips, Unocal, Agip, Burlington Resources, Devon Energy, Husky, Kerr-McGee, Newfield Exploration and Royal Dutch Shell. As of December 31, 2004, we were a party to 27 production sharing contracts. 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

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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:

24

- o large proved reserve base with significant exploitation opportunities;
- o sizable operating area with demonstrated exploration potential;
- o successful independent exploration and development record;
- o competitive cost structure;
- o reduced risks and access to capital and technology through production sharing contracts;
- o strategic position in China's growing natural gas markets; and
- o experienced management team.

Large proved reserve base with significant exploitation opportunities

Based on net proved reserves as of December 31, 2004 and average net daily production for the year ended December 31, 2004, we had a reserve-to-production ratio of 15.9 years. As of December 31, 2004, approximately 51.6% of our net proved reserves were classified as net proved undeveloped. We expect our production to grow significantly as these undeveloped properties begin producing.

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 prospective natural gas regions of the Western South China Sea and the East China Sea. Since CNOOC's inception in 1982 to the end of 2004, a total of 773 exploration wells have been drilled offshore China, including 491 wildcat wells with a success rate of approximately 34%. During the past five years ended December 31, 2004, we made 23 discoveries and foreign parties announced 16 discoveries offshore China.

Successful independent exploration and development record.

From the inception of CNOOC in 1982 to December 31, 2004, we achieved a success rate of approximately 45% on our 214 offshore China independent wildcat wells, while our foreign partners achieved a success rate of approximately 27% on their 277 offshore China wildcat wells. As of December 31, 2004, independent properties accounted for 61.0% of our total net proved reserves and independent net proved undeveloped reserves accounted for 64.7% of our total net proved undeveloped reserves. During the past five years ended December 31, 2004, we completed seven of our major independent development projects on time and under budget.

Competitive cost structure

For the year ended December 31, 2004, our total offshore China lifting costs were US\$5.31 per BOE. Total lifting costs for independent operations offshore China were US\$5.28 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.

25

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 gasfields near many of China's rapidly growing coastal areas, including Hong Kong, Shanghai and Tianjin. 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."

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:

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

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

As of December 31, 2004, approximately 51.6% 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 will substantially increase production. We plan to spend approximately US\$1,624.0 million in 2005 to develop our net proved undeveloped reserves offshore China. We also plan to spend approximately US\$207.5 million to develop our overseas net proved undeveloped reserves.

Add to our reserves through independent exploration and production sharing contracts

26

We plan to concentrate our independent exploration efforts in existing operating areas with a particular emphasis on natural gas. We plan to spend approximately US\$212.1 million in 2005 on independent exploration activities. We plan to augment independent exploration efforts while continuing to enter into production sharing contracts with foreign partners to lower capital requirements and exploration risks. We currently have identified 43 drilling prospects. In 2005, we plan to drill approximately 48 exploration wells, and acquire independently approximately 9,500 kilometers and 2,675 square kilometers of 2D seismic data and 3D seismic data, respectively. Our foreign partners under existing production sharing contracts plan to drill approximately 28 exploration wells, and acquire approximately 5,350 kilometers and 1,650 square kilometers of 2D seismic data and 3D seismic data, respectively, in 2005.

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:

- o continue to develop natural gas fields and focus independent exploration efforts on natural gas;
- o evaluate whether to exercise the options to invest in CNOOC's

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liquefied natural gas projects in China; and

- o 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. At the end of 2004, we and 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. 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. We have also made significant progresses implementing our natural gas strategy. In October 2003, we entered into an agreement with the participants in the Gorgon Joint Venture in Australia to purchase certain equity stake in the Gorgon gas development, and our controlling shareholder, CNOOC, will arrange to purchase LNG directly from Gorgon. In May 2004, we increased our interest in Indonesia's Tangguh LNG project from 12.5% to 16.96%. In addition, in December 2004, we completed the acquisition of a 5.3% interest in the upstream production and reserves of the North West Shelf project. We believe these upstream acquisitions of gas reserves will enhance our natural gas strategy by facilitating the supply of LNG to China's rapidly growing coastal markets 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:

- o 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,

27

multilateral wells, advanced formation testing, multi-phase transmission, monolayer pipeline and subsea technology, minimal structure techniques and suction foundation technology;

- o 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

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

Maintain financial flexibility through conservative 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	
	2002	2003
Net Production:		
Oil (daily average bbls/day).....	298,625	306,464
Gas (daily average mscf/day).....	272.6	291.0
Oil equivalent (BOE/day).....	346,639	356,729
Average net realized prices:		
Oil (per bbl).....	US\$24.35	US\$28.11
Gas (per mcf).....	2.98	2.87
Offshore China lifting costs (per BOE).....	3.92	4.66
Overseas lifting costs (per BOE) (1).....	9.06	9.27
Net Proved Reserves (end of period):		
Oil (mmbbls).....	1,424.4	1,436.1
Gas (bcf).....	3,547.9	4,154.4
Total (million BOE).....	2,015.8	2,128.5
Proved developed reserves (million BOE).....	794.3	914.6
Annual reserves replacement ratio.....	281%	187%
Estimated reserves life (years).....	15.9	16.3
Standardized measure of discounted future net cash flow (million Rmb).....	100,141	109,800

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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

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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 it in our filings with the Securities and Exchange Commission.

28

At our request, Ryder Scott Company, independent petroleum engineering consultants, carried out an independent evaluation of the reserves of selected properties as of December 31, 2002, 2003 and 2004. 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."

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

	Net proved reserves at December 31,		Net prov at Decembe	
	2002	2003	Developed	Unde
<b>Bohai Bay:</b>				
Crude oil (mmbbls).....	992.5	990.4	446.1	
Natural gas (bcf).....	598.6	566.6	268.1	
	-----	-----	-----	-----
Total (million BOE).....	1,092.3	1,084.8	490.8	
	=====	=====	=====	=====
Independent (million BOE).....	595.1	556.3	335.6	
Production sharing contracts (million BOE).....	497.2	528.5	155.2	
<b>Western South China Sea:</b>				
Crude oil (mmbbls).....	160.4	173.7	71.5	
Natural gas (bcf).....	2,511.2	2,564.0	1,832.8	
	-----	-----	-----	-----
Total (million BOE):.....	578.9	601.0	376.9	
	=====	=====	=====	=====
Independent (million BOE).....	434.2	476.7	260.2	
Production sharing contracts (million BOE).	144.7	124.3	116.7	
<b>Eastern South China Sea:</b>				
Crude oil (mmbbls).....	120.3	154.8	96.1	
Natural gas (bcf).....	42.8	548.2	--	
	-----	-----	-----	-----
Total (million BOE):.....	127.5	246.1	96.1	
	=====	=====	=====	=====

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Independent (million BOE).....	--	141.1	11.4	
Production sharing contracts (million BOE).	127.5	105.0	84.7	
East China Sea:				
Crude oil (mmbbls).....	12.5	13.9	3.1	
Natural gas (bcf).....	179.4	275.3	32.9	
	-----	-----	-----	-----
Total (million BOE):.....	42.4	59.8	8.6	
	=====	=====	=====	=====
Independent (million BOE).....	42.4	12.7	8.6	
Production sharing contracts (million BOE).	--	47.1	--	
Overseas:				
Crude oil (mmbbls).....	138.7	103.4	84.6	
Natural gas (bcf).....	215.9	200.3	138.5	
	-----	-----	-----	-----
Total (million BOE):.....	174.7	136.8	107.7	
	=====	=====	=====	=====
Independent (million BOE).....	--	--	--	
Production sharing contracts (million BOE).	174.7	136.8	107.7	
Total:				
Total crude oil (mmbbls).....	1,424.4	1,436.1	701.5	
Total natural gas (bcf).....	3,547.9	4,154.3	2,272.3	2,
	-----	-----	-----	-----
Total (million BOE):.....	2,015.8	2,128.5	1,080.2	1,
	=====	=====	=====	=====
Independent (million BOE).....	1,071.7	1,186.9	615.8	
Production sharing contracts (million BOE).	944.1	941.6	464.3	

29

New Contracts Signed in 2004

In 2004, our controlling shareholder, CNOOC, signed one petroleum contract as follows:

No.	Basin	Block	Partner	Interest of Partner (s) (%)	Date of Agreement	Ar
1	Eastern South China Sea	29/26	Husky Oil China	100	08/16/2004	

In 2004, we signed four petroleum contracts as follows:



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No.	Basin	Block	Partners	Interest of Partner(s) (%)	Date of Agreement
1	Myanmar	M	Golden Aaron Pte Limited HQCEC	13.75 5.0	10/21/04
2	Myanmar	A-4	Golden Aaron Pte Limited HQCEC	13.75 5.0	10/21/04
3	Myanmar	M-10	Golden Aaron Pte Limited HQCEC	13.75 5.0	10/21/04
4	Tangguh, Indonesia (1)	N/A	BP MI Berau BV Others	37.1 16.3 29.6	01/30/04

(1) We increase our interest in this project from 12.5% to 16.96 % in 2004.

30

Exploration and Production

Summary

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

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

[GRAPHIC OMITTED]

In addition, we hold several equity interests in oil and gas properties in overseas countries including Indonesia, Australia, Canada, Morocco 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."

31

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As of December 31, 2004, we had estimated net proved reserves of 2,230 million BOE, comprised of 1,455.6 million barrels of crude oil and condensate and 4,646.6 billion cubic feet of natural gas. As of December 31, 2004, we had interests in 36 producing properties and 37 properties under development and appraisal offshore China. We are the operator or joint operator of 21 oil and gas properties under production. In 2004, seven properties offshore China commenced production. For the year 2004, net production averaged 319,436 barrels per day of crude oil, condensate and natural gas liquids and 364 million cubic feet per day of natural gas, which together totaled 382,513 BOE per day, representing a 7.5% increase over the annual average daily production for the year 2003.

We conduct our exploration, development and production activities independently as well as through production sharing contracts and geophysical survey agreements 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, 2004, 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 873,355 kilometers of 2D seismic data and 41,584 square kilometers of 3D seismic data. From the beginning of CNOOC's operations in 1982 to December 31, 2004, a total of 773 exploration wells have been drilled, including 491 wildcat wells, with a success rate of approximately 34%. During this period we achieved a success rate of approximately 45% on 214 independent exploration wildcat wells, while our foreign partners achieved a success rate of approximately 27% on their 277 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, 2004, approximately 51.6% 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 total reserves, comprised of (i) our 100% interest in our independent oil and gas properties (excluding the proved reserves attributable to our associated company), (ii) our participating interest in the properties covered under our production sharing contracts in the PRC and overseas, and (iii) our 30% interest in the proved reserves of our associated company, less (i) an

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adjustment for our share of royalties payable to the PRC government under our production sharing contracts in the PRC, (ii) an adjustment for production allocable to foreign partners under our production sharing contracts in the PRC as reimbursement for exploration expenses attributable to our working interest, and (iii) adjustments for share oil payable under our overseas production sharing contracts to foreign governmental designees, and for any domestic market obligation under which the contractor must sell a specified percentage of its crude oil to the local overseas market at a reduced price. 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.

32

We explore for 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 consultant, evaluated our selected properties as of December 31, 2002, 2003 and 2004. 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.

### Total Net Proved Crude Oil Reserves (mmbbls)

	As of December 31,		As of Decem	
	2002	2003	Developed	Unde
Offshore China				
Independent				
Bohai Bay.....	507.8	474.3	291.0	1
Western South China Sea.....	108.4	135.2	29.6	1
Eastern South China Sea.....	--	56.6	11.4	
East China Sea.....	12.5	4.6	3.1	
Total.....	628.7	670.8	335.1	3
Production Sharing Contracts				
Bohai Bay.....	484.7	516.1	155.2	3
Western South China Sea.....	52.0	38.5	41.9	
Eastern South China Sea.....	120.3	98.1	84.7	
East China Sea.....	--	9.3	--	
Total.....	657.0	662.0	281.8	3

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Combined				
Bohai Bay.....	992.5	990.4	446.2	5
Western South China Sea.....	160.4	173.7	71.5	1
Eastern South China Sea.....	120.3	154.8	96.1	
East China Sea.....	12.5	13.9	3.1	
	-----	-----	-----	-----
Total.....	1,285.7	1,332.7	616.9	7
Overseas (1)				
Indonesia.....	138.7	103.4	84.6	
	-----	-----	-----	-----
Total.....	138.7	103.4	84.6	
	-----	-----	-----	-----
Total.....	1,424.4	1,436.1	701.5	7
	=====	=====	=====	=====

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(1) As of December 31, 2004, our net proved reserves 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.

33

Total Net Proved Natural Gas Reserves  
(bcf)

	As of December 31,		As of Decem	
	2002	2003	Developed	Undev
	-----	-----	-----	-----
Offshore China				
Independent				
Bohai Bay.....	524.2	491.9	268.1	4
Western South China Sea.....	1,954.2	2,049.3	1383.9	6
Eastern South China Sea.....	--	506.9	--	6
East China Sea.....	179.4	48.7	32.9	3
	-----	-----	-----	-----
Total.....	2,657.7	3,096.8	1,684.9	2,1
Production Sharing Contracts				
Bohai Bay.....	74.5	74.7	--	
Western South China Sea.....	557.0	514.7	448.9	
Eastern South China Sea.....	42.8	41.2	--	
East China Sea.....	--	226.7	--	
	-----	-----	-----	-----
Total.....	674.2	857.3	448.9	
Combined				
Bohai Bay	598.6	566.6	268.1	4
Western South China Sea.....	2,511.2	2,564.0	1,832.8	6
Eastern South China Sea.....	42.8	548.2	--	7
East China Sea.....	179.4	275.3	32.9	3
	-----	-----	-----	-----

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Total.....	3,332.0	3,954.1	2,133.8	2,133.8
Overseas (1)				
Indonesia.....	216.0	200.3	138.5	138.5
	-----	-----	-----	-----
Total.....	216.0	200.3	138.5	138.5
	-----	-----	-----	-----
Total.....	3,547.9	4,154.4	2,272.3	2,272.3
	=====	=====	=====	=====

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(1) As of December 31, 2004, our net proved reserves 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.

34

Total Net Proved Reserves  
(million BOE)

	As of December 31,		As of December 31,	
	2002	2003	Developed	Undeveloped
	-----	-----	-----	-----
Offshore China				
Independent				
Bohai Bay.....	595.2	556.3	335.6	260.7
Western South China Sea.....	434.1	476.7	260.2	260.2
Eastern South China Sea.....	--	141.1	11.4	11.4
East China Sea.....	42.4	12.7	8.6	8.6
	-----	-----	-----	-----
Total.....	1,071.7	1,186.9	615.8	540.9
Production Sharing Contracts				
Bohai Bay.....	497.1	528.5	155.2	373.3
Western South China Sea.....	144.8	124.3	116.7	116.7
Eastern South China Sea.....	127.5	105.0	84.7	84.7
East China Sea.....	--	47.1	--	--
	-----	-----	-----	-----
Total.....	769.4	804.9	356.6	548.3
Combined				
Bohai Bay.....	1,092.3	1,084.8	490.8	634.0
Western South China Sea.....	578.9	601.0	376.9	376.9
Eastern South China Sea.....	127.5	246.1	96.1	96.1
East China Sea.....	42.4	59.8	8.6	8.6
	-----	-----	-----	-----
Total.....	1,841.0	1,991.7	972.5	1,115.6
Overseas (1)				
Indonesia.....	174.7	136.7	107.7	107.7
	-----	-----	-----	-----
Total.....	174.7	136.7	107.7	107.7
	-----	-----	-----	-----
Total.....	2,015.8	2,128.5	1,080.2	1,123.3

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 (1) As of December 31, 2004, our net proved reserves 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.

35

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,	
	2002	2003
Offshore China		
Independent		
Bohai Bay.....	110,989	98,790
Western South China Sea.....	35,724	27,547
Eastern South China Sea.....	--	13,708
East China Sea.....	3,223	2,536
Total.....	149,936	142,581
Production Sharing Contracts		
Bohai Bay.....	16,767	30,716
Western South China Sea.....	21,186	33,397
Eastern South China Sea.....	73,792	59,273
East China Sea.....	--	--
Total.....	111,745	123,386
Combined		
Bohai Bay.....	127,756	129,506
Western South China Sea.....	56,910	60,944
Eastern South China Sea.....	73,792	72,981
East China Sea.....	3,223	2,536
Total.....	261,681	265,967
Overseas (1)		
Indonesia.....	36,944	40,497
Total.....	36,944	40,497

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Total.....	298,625	306,464
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(1) As of December 31, 2004, 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.

36

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

	Year ended December 31,	
	2002	2003
Offshore China		
Independent		
Bohai Bay.....	47.1	47.1
Western South China Sea.....	4.4	29.1
Eastern South China Sea.....	--	--
East China Sea.....	12.4	14.2
Total.....	64.0	90.4
Production Sharing Contracts		
Bohai Bay.....	--	--
Western South China Sea.....	137.9	98.7
Eastern South China Sea.....	--	--
East China Sea.....	--	--
Total.....	137.9	98.7
Combined		
Bohai Bay.....	47.1	47.1
Western South China Sea.....	142.3	127.8
Eastern South China Sea.....	--	--
East China Sea.....	12.4	14.2
Total.....	201.8	189.1
Overseas(1)		
Indonesia.....	70.8	101.9
Total.....	70.8	101.9
Total.....	272.6	291.0

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 (1) As of December 31, 2004, 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.

37

	Average Daily Net Production (BOE per day)	
	Year ended December 31,	
	2002	2003
Offshore China		
Independent		
Bohai Bay.....	118,845	106,637
Western South China Sea.....	36,456	32,391
Eastern South China Sea.....	--	13,708
East China Sea.....	5,283	4,908
Total.....	160,584	157,644
Production Sharing Contracts		
Bohai Bay.....	16,767	30,716
Western South China Sea.....	46,747	51,619
Eastern South China Sea.....	73,792	59,274
East China Sea.....	--	--
Total.....	137,306	141,609
Combined		
Bohai Bay.....	135,612	137,353
Western South China Sea.....	83,203	84,010
Eastern South China Sea.....	73,792	72,981
East China Sea.....	5,283	4,908
Total.....	297,890	299,252
Overseas (1)		
Indonesia.....	48,749	57,477
Total.....	48,749	57,477
Total.....	346,639	356,729

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 (1) As of December 31, 2004, our net production attributable to overseas



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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, 2004, 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, 2004, 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 numerous 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, 2004, net proved reserves in this region were 974.6 million barrels of crude oil and condensate and 706.2 billion cubic feet of natural gas, totaling 1,092.3 million BOE and representing approximately 49.0% 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. Four discoveries were made in this area in 2004, including three by us and one by our foreign partners.

38

The following table sets forth principal exploration blocks under an exploration license for both our independent operations and our production sharing contracts in the Bohai Bay as of December 31, 2004. All exploration licenses expiring prior to June 8, 2005 are being renewed.

Block	Approximate block area (km <sup>2</sup> )	Partner(s)	Exploration Lic Commencement date
Independent			
Middle of Bohai Bay	4,974	--	04/26/04
Southern Bohai Bay	3,679	--	08/06/04
Western Bohai Bay	1,895	--	06/08/04
Western Liaodong Bay	3,344	--	03/31/00
Eastern Liaodong Bay	2,829	--	07/02/01

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Eastern Bozhong	1,861	--	05/30/04
06/17	2,586	--	02/20/05
02/31	4,990	--	05/29/03
Bohai 09/11	843	--	04/05/04

PSC

05/36	2,766	Kerr-McGee, Newfield, Sino-American Energy	04/07/05
Eastern Bohai 11/05	3,601	ConocoPhillips	08/16/04
Western Bohai 11/05	2,897	ConocoPhillips	02/10/04
11/19	3,068	ChevronTexaco	05/29/04
09/18	2,218	Kerr-McGee	04/02/05
04/36	1,694	Kerr-McGee, Sino-American Energy	04/02/05

During the year ended December 31, 2004, we independently acquired 1,764 square kilometers of 3D seismic data and our foreign partners acquired 390 square kilometers of 3D seismic data in the Bohai Bay. We have an aggregate of approximately 178,893 kilometers and 9,755 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 9,176 square kilometers of additional 2D and 3D seismic data, respectively, in this area. During the year of 2004, we drilled eight wildcat wells, three of which were successful, and 11 appraisal wells, all of which were successful. During the same period, our production sharing contract partners drilled seven wildcat wells, one of which was successful, and one appraisal well, which was successful. Our exploration capital expenditures for 2004 were US\$74.4 million. In 2005, we plan to drill 25 exploration wells in the Bohai Bay.

For 2004, net production in this region averaged 134,512 barrels per day of crude oil, condensate and natural gas liquids and 47.7 million cubic feet per day of natural gas, representing approximately 37.2% of our total daily net production. Our development capital expenditures for the Bohai Bay for 2004 were US\$762.2 million.

The following table sets forth our principal oil and gas properties under production in the Bohai Bay as of December 31, 2004.

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Block/Field	Operator (s)	Partner (s)	Our interest	Average net production for year 2004 (BOE per day)	Net pr as o (mi
Liaoxi					
Suizhong 36-1	CNOOC Limited	--	100%	60,475	
Jinzhou 9-3	CNOOC Limited	--	100%	13,225	
Jinzhou 20-2	CNOOC Limited	--	100%	7,710	
Boxi					
Boxi Oilfields(1)	CNOOC Limited	--	100%	12,800	
Chengbei					
Chengbei Oilfield	CNOOC Limited	--	100%	4,523	
Qinhuangdao					
Qinhuangdao 32-6	CNOOC Limited	ChevronTexaco	75.5%	22,429	
Bonan					
Bozhong 34-2/4	CNOOC Limited	--	100%	1,886	
Bonan fields	CNOOC Limited	--	100%	2,107	
Bozhong 25-1/1S	CNOOC Limited	ChevronTexaco	83.8%	4,073	
11/05					
Penglai 19-3	ConocoPhillips	Phillips Bohai	51%	8,871	
04/36					
Caofeidian 11-1/2	Kerr-McGee	Sino-American Energy	51%	4,371	

(1) The production and reserves data of Boxi Oilfields includes the production and reserves of Qikou 18-2, which commenced operations in 2004.

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The following table sets forth our principal oil and gas properties under development in the Bohai Bay as of December 31, 2004.

Block/Field	Operator(s)	Partner(s)	Our interest	Net proved Decem (mi
Liaoxi				
Luda 4-2/5-2/10-1	CNOOC Limited	--	100%	
Jinzhou 21-1	CNOOC Limited	--	100%	
JZ 25-18	CNOOC Limited	--	100%	
Boxi				
Qikou 18-9	CNOOC Limited	--	100%	
Caofeidian 18-1	CNOOC Limited	--	100%	
Caofeidian 18-2	CNOOC Limited	--	100%	
Qinhuangdao				
Qinhuangdao 33-1	CNOOC Limited	--	100%	
Bozhong				
Nanbao 35-2	CNOOC Limited	--	100%	
Bonan				
Bozhong 34-1/34-1s	CNOOC Limited	--	100%	
11/05				
Penglai 25-6	ConocoPhillips	Phillips Bohai	51%	
04/36 & 05/36				
Caofeidian 12-1/12-1S	Kerr-McGee	Sino-American Energy, New Field	51%	
Caofeidian 11-3/11-5	Kerr-McGee	Sino-American Energy	51%	

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### 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 area. As of December 31, 2004, 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, 2004, we had net proved reserves of 189.7 million barrels of crude oil and condensate and 2,484.8 billion cubic feet of natural gas in this region, totaling 603.8 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. During the year ended December 31, 2004, we drilled five wildcat wells, and three appraisal wells. All three of the appraisal wells we drilled were successful. Our production sharing contract partners drilled two wildcat wells and two appraisal wells. One of the two appraisal wells our production sharing contract partners drilled was successful.

41

The following table sets forth the principal exploration blocks under an exploration license for both our independent operations and our production sharing contracts in the Western South China Sea as of December 31, 2004.

Block	Approximate block area (km <sup>2</sup> )	Partner(s)	Exploration Licen	
			Commencement date	E
Independent				
Ledong 01	6,543	--	12/03/03	
Lingsui 18	7,738	--	08/06/02	
Weizhou 12	6,980	--	05/11/01	
Weizhou 26	4,358	--	11/05/03	
Yulin 35	6,050	--	05/11/01	
Qionghai 28	5,208	--	05/11/01	

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Lingtou 20	2,684	--	08/30/00
Lingao 11	4,117	--	05/11/01
Songtao 22	4,063	--	05/11/01
Songtao 31	5,264	--	05/11/01
Yangjiang 31	6,003	--	12/03/03
Wenchang 11	4,901	--	05/11/01
PSC			
Wanan North 21A	6,801	Benton Offshore China Company	09/30/03
Wanan North 21B	6,118	Benton Offshore China Company	09/30/03
Wanan North 21C	6,372	Benton Offshore China Company	09/30/03
Wanan North 21D	6,126	Benton Offshore China Company	09/30/03

During the year ended December 31, 2004, we independently acquired 13,827 kilometers of 2D seismic data and 1,047 square kilometers of 3D seismic data in the Western South China Sea. We have an aggregate of approximately 180,840 kilometers and 8,057 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 2004 were US\$68.9 million. In 2005, we plan to drill 13 exploration wells in the Western South China Sea area.

For the year ended December 31, 2004, net production averaged 55,873 barrels per day of crude oil, condensate and natural gas liquids and 215.2 million cubic feet per day of natural gas, representing 24.6% of our total daily net production. Our development capital expenditures for the Western South China Sea for 2004 were US\$91.5 million.

The following table sets forth the principal oil and gas properties in the Western South China Sea area that were under production as of December 31, 2004.

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Block/Field	Operator(s)	Partner(s)	Our interest	Average net production for year 2004 (BOE per day)	December 31, 2004 (millions of BOE)
Yinggehai					
Yacheng 13-1(1)	CNOOC Limited	Kufpec BPCEPC	51%	25,403	
Yulin 35					
Weizhou Oilfields(2)	CNOOC Limited	--	100%	27,832	
Wenchang 13-1/13-2					
Wenchang 13-1/13-2	CNOOC Limited	Husky	60%	28,051	
Changjiang 25					
Dongfang 1-1	CNOOC Limited	--	100%	12,851	

(1) On January 1, 2004, we took over operation of Yacheng 13-1 from BP.

(2) The reserves data of Weizhou Oilfields includes the reserves of Weizhou 12-1N.

The following table sets forth the principal oil and gas properties in the Western South China Sea area that were under development as of December 31, 2004.

Block/Field	Operator(s)	Partner(s)	Our interest	Net proved December 31, 2004 (millions of BOE)
Yulin 35				
Weizhou 11-1	CNOOC Limited	--	100%	
Weizhou 11-4N	CNOOC Limited	--	100%	
Wenchang 14-3	CNOOC Limited	--	100%	
Weizhou 6-1	CNOOC Limited	--	100%	

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Weizhou 11-1N	CNOOC Limited	--	100%
-----			
Yangjiang 31 and 32			
-----			
Wenchang 8-3	CNOOC Limited	--	100%
-----			
Wenchang 19-1	CNOOC Limited	--	100%
-----			
Wenchang 15-1	CNOOC Limited	--	100%
-----			
Yinggehai			
-----			
Yacheng 13-4	CNOOC Limited	--	100%
-----			
Ledong 01			
-----			
Ledong	CNOOC Limited	--	100%
-----			

### 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, 2004, 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, 2004, we had net proved reserves of 168.0 million barrels of crude oil and condensate and 730.8 billion cubic

43

feet of natural gas in this region, totaling 289.8 million BOE and representing approximately 13.0% of our total net proved reserves.

During the year ended December 31, 2004, we drilled three wildcat wells, one of which was successful, and three appraisal wells, all of which were successful. Our production sharing contract partners drilled two wildcat wells. We made one new oil and gas discovery in the Eastern South China Sea in 2004.

The following table sets forth the principal exploration blocks that are under an existing exploration license for both our independent operations and our production sharing contracts in the Eastern South China Sea as of December 31, 2004.



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Block	Approximate block area (km <sup>2</sup> )	Partner(s)	Explorati Commencement date
Independent			
Enping 15 (Pearl River Mouth)	5,833	--	05/11/01
Enping 10 (Pearl River Mouth)	6,547	--	05/11/01
Panyu 33 (Pearl River Mouth)	4,830	--	05/11/01
Liuhua 07 (Pearl River Mouth)	4,172	--	05/11/01
Xijiang 04 (Pearl River Mouth)	7,969	--	05/11/01
Lufeng 06 (Pearl River Mouth)	4,457	--	05/11/01
Huizhou 31 (Pearl River Mouth)	3,074	--	05/11/01
Kaiping 14 (Pearl River Mouth)	7,753	--	05/11/01
Kaiping 32 (Pearl River Mouth)	8,104	--	05/11/01
Dongsha 32 (Pearl River Mouth)	7,350	--	11/05/03
PSC			
15/34	4,984	Devon, Burlington	12/24/03

For the year ended December 31, 2004, we independently acquired 6,560 kilometers of 2D seismic data and 1,329 square kilometers of 3D seismic data in the Eastern South China Sea area. We have an aggregate of approximately 66,305 kilometers and 2,658 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 109,262 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 2004 were US\$52.5 million. We plan to drill six exploration wells in the Eastern South China Sea in 2005.

For the year ended December 31, 2004, net production averaged approximately 96,989 barrels per day of crude oil, representing approximately 25.4% of our total daily net production. Our development capital expenditures for this region for 2004 were US\$358.6 million.

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under production in the Eastern South China Sea as of December 31, 2004.

Production Block/Field	Operator(s)	Partner(s)	Our interest	Average net production for year 2004 (BOE per day)
16/08				
Huizhou Oilfields	CACT	Eni, ChevronTexaco	51%	15,596
16/19				
Huizhou 19-3/2/1	CACT	Eni, ChevronTexaco	51%	247
15/11				
Xijiang 24-3	CNOOC Limited, ConocoPhillips	Pecten	51%	15,979
15/22				
Xijiang 30-2	CNOOC Limited, ConocoPhillips	Pecten	40%	10,968
29/04				
Liuhoa 11-1	CNOOC Limited	--	100%	19,497
16/06				
Lufeng 13-1	JHN	Japex, New Huanan, NWC	25%	2,851
17/22				
Lufeng 22-1	CNOOC Limited, Statoil	Statoil	25%	536
15/34				

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Panyu 4-2/5-1    Devon                                      Burlington                                      51%                                      31,315

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The following table sets forth our principal oil and gas properties under development in the Eastern South China Sea as of December 31, 2004.

Block/Field	Operator(s)	Partner(s)	Our interest	Net prove Decem (mi
Liuhua 07				
Panyu 30-1	CNOOC Limited	--	100%	
Panyu 33				
Panyu 34-1	CNOOC Limited	--	100%	
Xijiang 04				
Xijiang 23-1	CNOOC Limited	--	100%	
16/06				
Lufeng 13-2	CNOOC Limited	--	100%	

**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, 2004, 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

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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 mid 2005. 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, 2004, our net proved reserves in the Xihu Trough were 17.7 million barrels of crude oil and condensate and 360.2 billion cubic feet of natural gas, totaling 77.7 million BOE and representing 3.5% of our total net proved reserves. We are the operator of the project.

During the year ended December 31, 2004, we drilled three wildcat wells. Our production sharing contract partners drilled one wildcat well, which was successful.

The following table sets forth the principal exploration blocks under an existing exploration license or pending exploration license for both our independent operations and our production sharing contracts in the East China Sea as of December 31, 2004. All exploration licenses expiring prior to June 8, 2005 are being renewed.

Block	Approximate block area (km <sup>2</sup> )	Partner(s)	Explorati Commencement date
-----			
Independent			
Xihu Tiantai 32	5,400	--	07/17/01
Xihu Huangyan 04	2,848	--	08/28/01
Xihu Hangzhou 26	3,642	--	03/31/03
Xihu Hangzhou 17	4,227	--	08/28/01
Xihu Zhenhai 01	1,536	--	08/28/01
Lishui-Jiaojiang	6,767	--	03/31/00
North Yellow Sea	6,471	--	05/25/01
Fuzhou 02	3,064	--	05/11/01
Northern Trough	912	--	08/30/00
Taibei 27	7,379	--	07/09/01
Jinhua 12	6,931	--	05/11/01
Kunshan 02	2,628	--	05/11/01

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Taoyuan 07	6,457	--	07/09/01
Jilong 25	5,692	--	07/09/01
PSC			
32/32	513	Primeline Petroleum	07/11/02

During the year ended December 31, 2004, we independently acquired 4,058 kilometers of 2D seismic data in this area. We have an aggregate of approximately 115,990 kilometers and 377 square kilometers of independent 2D 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

46

kilometers, respectively, of additional 2D and 3D seismic data in this area. Our exploration capital expenditures for the East China Sea for 2004 were US\$16.6 million. We plan to drill five exploration wells in this area in 2005.

For the year ended December 31, 2004, our net production in this region averaged 2,121 barrels per day of crude oil, condensate and natural gas liquids and 17.1 million cubic feet per day of natural gas, representing 1.3% of our total daily net production. Our development capital expenditures for the East China Sea for 2004 were US\$161.2 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, 2004.

Block/Field	Operator(s)	Partner(s)	Our interest	Average net production for year 2004 (BOE per day)
Production				
Pinghu				
Pinghu Gasfield(1)	CNOOC Limited	Sinopec, Shanghai Shenneng Corporation	30%	4,963
Development				
Xihu Trough				

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Canxue	CNOOC Limited	Sinopec	50%	--
Duanqiao	CNOOC Limited	Sinopec	50%	--
Chunxiao	CNOOC Limited	Sinopec	50%	--
Tianwaitian	CNOOC Limited	Sinopec	50%	--
Baoyunting	CNOOC Limited	Sinopec	50%	--
Wuyunting	CNOOC Limited	Sinopec	50%	--

(1) This field is under license to the Shanghai Petroleum and Natural Gas Company in which we have a 30% interest.

### 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 acquisition of 5.3% interest in the upstream production and reserves located in the North West Shelf of Australia and 25% interest in the related China LNG joint venture. 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 as of December 31, 2004 were approximately 155.5 million BOE.

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

- o 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

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barrels of oil in over 20 years of production. The concession expires in 2018.

- o Offshore North West Java Production Sharing Contract. The Indonesian subsidiaries own a 36.7% 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.
- o 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.
- o 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 39.5% 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 a 11.25% interest in a petroleum agreement for Ras Tafelney offshore Morocco.

At the end of 2004, we and 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. 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.

As of December 31, 2004, our net proved reserves in our overseas

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properties were 101.9 million barrels of crude oil and 321.4 billion cubic feet of natural gas. For 2004, net production from our overseas properties averaged 29,941 barrels per day of crude oil, condensate and natural gas liquids and 84.1 million cubic feet of natural gas, representing approximately 9.4% and 23.1%, 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.

48

We and our partner Kodeco made one new oil and gas discovery in the West Madura PSC area within the East Java Sea of Indonesia.

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 the principal oil and gas properties under production in our overseas interests as of December 31, 2004.

PSC	Operator(s)	Partner(s)	Our interest	Average net production for year 2004 (BOE per day)
South East Sumatra	CNOOC SES Limited	INPEX Sumatra KNOC Sumatra MC Oil & Gas Sumatra Paladin Indonesia (Sunda) Paladin UK (Southeast Sumatra) Paladin Resources (Bahamas) CNOOC SES Limited	65.3%	21,918
Offshore North West Java	BP	CNOOC ONWJ INPEX Jaws MC Oil and Gas Java C. ITOH Energy Paladin Resources (Sunda) BP West Java	36.7%	13,078
West Madura	Kodeco Energy	Pertamina CNOOC Madura KODECO Energy	25.0%	1,969
Poleng(1)	Korea Development	CNOOC Poleng Korea Development	50.0%	4,974
Blora	Lundin Blora	CNOOC Blora Paladin Resources Amerada Hess	16.7%	--



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		Lundin Biora	
		OOGC Mallaca	39.5%
		Mallaca Petroleum	2,016
Malacca Strait	Kondur Petroleum	Imbang Tata Alam	
		Kondur Petroleum	

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(1) Our interest in this contract area is in the form of a technical assistance contract.

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.

	Year ended D	
	2002	2003
	(US\$)	(US\$)
Average Sales Prices of Petroleum Produced		
Per Barrel of Crude Oil, Condensate and Natural Gas Liquid Sold.....	24.35	
Per Thousand Cubic Feet of Natural Gas Sold.....	2.98	
Offshore China Average Lifting Costs per BOE Produced		
Independent.....	3.89	
Production Sharing Contracts.....	3.95	
Offshore China Average.....	3.92	
Overseas Average Lifting Costs per BOE Produced		
Net Entitlement.....	9.06	

Drilling and Productive Wells

The following table sets forth our exploratory and productive wells drilled offshore China as of December 31, 2004 by independent and production

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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, 2004			
	Total	Bohai Bay	Western South China Sea	Eastern South China Sea
<b>Independent</b>				
Net Exploratory Wells.....	494	297	161	20
Net Productive Wells.....	490.4	382	78	25
Crude Oil.....	463.7	370	66	25
Natural Gas.....	26.7	12	12	--
<b>Production Sharing Contracts</b>				
Net Exploratory Wells.....	14	--	--	0.5
Net Productive Wells.....	1,074.4	203.3	20	75
Crude Oil.....	821.7	203.3	14.4	74
Natural Gas.....	252.7	--	5.6	1
<b>Totals</b>				
Net Exploratory Wells.....	508	297	161	20.5
Net Productive Wells.....	1,564.8	585.3	98	100
Crude Oil.....	1,285.4	573.3	80.4	99
Natural Gas.....	279.4	12	17.6	1

50

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, 2004, 2003 and 2002.

	Year ended December 31, 200			
	Total	Bohai Bay	Western South China Sea	Eastern South China Sea

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Independent				
Net Exploratory Wells Drilled.....	36	19	8	6
Successful.....	21	14	3	4
Dry.....	15	5	5	2
Net Development Wells Drilled.....	40	34	4	2
Successful.....	40	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.....	--	--	--	--

Year ended December 31, 200

	Total	Bohai Bay	Western South China Sea	Eastern South China Sea	Eas Chi
-----					
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	--	--	--	

51

Year ended December 31, 200

	Total	Bohai Bay	Western South China Sea	Eastern South China Sea	Eas Chi
-----					
Independent					
Net Exploratory Wells Drilled.....	41.5	15.0	20.0	5.0	

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Successful.....	19.0	12.0	3.0	3.0
Dry.....	22.5	3.0	17.0	2.0
Net Development Wells Drilled.....	14.0	2.0	12.0	--
Successful.....	14.0	2.0	12.0	--
Dry.....	--	--	--	--
Production Sharing Contracts				
Net Exploratory Wells Drilled.....	3.1	--	--	--
Successful.....	1.9	--	--	--
Dry.....	1.2	--	--	--
Net Development Wells Drilled.....	65.0	20.2	3.6	3.1
Successful.....	60.7	20.2	3.6	3.1
Dry.....	4.3	--	--	--

52

### 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 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. 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 Hongkong 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 trunkline. 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

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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 trunkline 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.

**Shandong Pipeline.** In September 2001, CNOOC signed an agreement with Shandong provincial government to participate in the planning of a Shandong natural gas pipeline network for LNG imports. In July 2002, a joint venture was established to develop this natural gas pipeline network, which consists of two trunklines of 156 kilometer in aggregate and a branch trunkline of 36 kilometer. CNOOC, a Shandong government affiliate and a Hong Kong company each own 25%, 50% and 25%, respectively, of the joint venture. Natural gas from the Bohai Bay landed in Longkou of Shandong Province in October 2004. Natural gas can be further transported to other cities in Shandong Province by pipeline.

53

**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 trunkline. 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 considerations 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

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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 2008. In May 2003, two large South Korean companies selected the Tangguh LNG project as their preferred supplier of up to 1.35 million tonnes per year of liquefied natural gas. The Tangguh LNG partners have also signed contracts to provide liquefied natural gas to North America. In addition, we entered into a repurchase agreement whereby put options and call options were granted to us and the sellers, respectively, to sell or repurchase, as the case may be, the interests in these production sharing contracts. The exercise prices of the options are determined based on the original consideration plus interest and additional investment and draw down made during the interim period. The options are exercisable if on or before December 31, 2004:

- o the LNG supply contract is terminated due to the non-satisfaction of the conditions precedent to the LNG supply contract; or
- o the LNG supply contract is otherwise legally ineffective.

These put options and call options have lapsed since neither of the above circumstances occurred on or before December 31, 2004.

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. Our estimated share of reserves from this project would be approximately 1.2 trillion cubic feet of natural gas. Our share of natural gas together with associated liquids is expected to be approximately 227 million BOE. Woodside Petroleum is the operator for the project.

54

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 previously entered into with them, under which we

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agreed to acquire certain interest in the upstream production and reserves of the Gorgon natural gas project.

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,				
	2002		2003		
	Rmb'000	%	Rmb'000	%	Rmb'
Independent operations.....	10,362,062	39.3	12,049,054	29.4	16,10
Production sharing contracts.....	14,617,400	55.4	20,231,534	49.4	24,39
Trading businesses.....	2,377,469	9.0	12,398,661	30.3	18,19
Unallocated and elimination.....	(983,116)	(3.7)	(3,728,976)	(9.1)	(3,47
<b>Total operating revenues.....</b>	<b>26,373,815</b>	<b>100.0</b>	<b>40,950,273</b>	<b>100.0</b>	<b>55,22</b>

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, 2004, approximately 55.1% of our total revenue was contributed by PRC customers. Our overseas activities are mainly conducted in Indonesia and Singapore.

### 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. We have been allowed to determine where we sell our products, both domestically and internationally. 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	
	2002	2003
Sales and Marketing Volumes (benchmark)		
(mmbbls) (1)		
Nanhai Light (APPI(2) Tapis(3)).....	26.4	20.4
Medium Grade (Daqing OSP(4)).....	64.7	69.6
Heavy Crude (APPI(2) Duri(5)).....	52.7	60.2
Average Realized Prices (US\$/bbl) (6)		
Nanhai Light.....	US\$24.79	US\$30.27
Medium Grade.....	25.92	29.45
Heavy Crude.....	22.79	26.56
Benchmark Prices (US\$/bbl)		
APPI(2) Tapis(3) .....	US\$25.49	US\$29.59
Daqing OSP(4) .....	24.95	28.94
APPI(2) Duri(5) .....	21.94	25.46
ICP(7) Cinta(8).....	24.08	28.04
ICP Widuri(9).....	24.08	28.05
West Texas Intermediate (US\$/bbl).....	US\$26.16	US\$31.07

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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.
  - (8) Cinta is a medium crude oil produced in Indonesia and was not a relevant benchmark for our crude oil sales prior to the acquisition of the Indonesian subsidiaries in 2002.
  - (9) Widuri is a medium crude oil produced in Indonesia and was not a relevant benchmark for our crude oil sales prior to the acquisition of the Indonesian subsidiaries in 2002.



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The international benchmark crude oil price, West Texas Intermediate, was US\$43.45 per barrel as of December 31, 2004 and US\$52.54 per barrel as of June 8, 2005.

### 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, 2002, 2003 and 2004, we sold approximately 85.1%, 73.5% and 81.2%, respectively, of our crude oil in the PRC, and exported approximately 14.9%, 26.5% and 18.8%, 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

56

industry in July 1998, some refineries and petrochemical companies were transferred to PetroChina from Sinopec. For the years ended December 31, 2002, 2003 and 2004, sales to Sinopec were approximately 44.7%, 36.8% and 38.4%, respectively, and sales to PetroChina were approximately 7.7%, 7.7% and 7.0%, respectively, of total crude oil sales in the PRC domestic market. Together these two customers accounted for approximately 52.4%, 44.5% and 45.4%, 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 26 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	
	2002	2003
	(Rmb in millions, except percent)	
Revenues sourced in the PRC.....	22,781	25,416
Revenues sourced outside the PRC.....	3,593	15,534
Total revenues.....	26,374	40,950
% of revenues sourced outside the PRC.....	13.6%	37.9%

### Sales Contracts

We sign sales contracts with customers for each shipment. Sales contracts are standard form contracts containing ordinary commercial terms

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such as quality, quantity, price, delivery and payment. All sales are made on free-on-board terms. Our customers are required to make payments within 30 days after the shipper takes possession of the crude oil cargo at our delivery points. As of December 31, 2002, 2003 and 2004, substantially all of our account receivables were aged within six months. During the years ended December 31, 2002, 2003 and 2004, the accounts receivable turnover were approximately 32.7 days, 47.5 days and 42.3 days, respectively. Doubtful accounts provision during the years ended December 31, 2002, 2003 and 2004 were nil, Rmb 1.5 million 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:

Annual gross production

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Less than 2 billion cubic meters.....	.....
2-3.5 billion cubic meters.....	.....
3.5-5 billion cubic meters.....	.....
Above 5 billion cubic meters.....	.....

We sell a large portion of our offshore China natural gas production to Hong Kong. The remaining offshore China natural gas production is sold to customers in mainland China. Of the 102.5 billion cubic feet of natural gas that we produced offshore China in the year ended December 31, 2004, 48.2 billion cubic feet was produced from the Yacheng 13-1 gasfield in the Western

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South China Sea. This field is governed by a production sharing contract we entered into with BP and Kufpec. We hold a 51% participating interest in this field. 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 37.8% of our total offshore China natural gas production for the year ended December 31, 2004. Castle Peak Power is a 60/40 joint venture between ExxonMobil Energy Limited and CLP Power Hong Kong Limited, a public utility company in Hong Kong. We sold the remaining 62.2% of our total offshore China natural gas production in 2004 to PRC customers, including Hainan Fertilizer, Hainan Minsheng Gas, Hainan Yangpu Power, Shanghai Gas, Jingxi Chemical, Xinao Gas, Tianjin Binhai Power, Tianjin Binhai Gas and Shandong Yantai Zhongshi Gas.

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 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 affiliates.

In the development stage, we normally employ independent third parties for mooring and oil tanker transportation 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 transport 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 and quality.

### 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. In 1998, the PRC government restructured PetroChina and Sinopec into vertically integrated companies with each having both upstream and downstream petroleum businesses and operations.

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 increased 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.

58

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 one million tons, or seven million BOE, per year for our crude oil production and for up to 70.6 billion cubic feet, or 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

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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

59

### 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 and an overall development plan to CNOOC upon discovery of petroleum reserves. The overall development plan must also be submitted to a joint management committee established under the production sharing contract. 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 petroleum 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, 2004, we had 27 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, to a lesser extent, through direct negotiation.

### Bidding Process

The bidding process typically involves the following steps:

- o 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;

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- o CNOOC invites foreign enterprises to bid;
- o 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
- o 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 less than 30 years and has three distinct phases:

- o Exploration. The exploration period generally lasts for seven consecutive years depending on the size of the contract area, and may be extended with the consent of CNOOC. 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.

60

- o Development. The development period begins on the date that the overall development plan, which outlines the recoverable reserves and schedule for developing the discovered petroleum reserves, is approved by the relevant PRC regulatory authorities. The development phase ends when the design, construction, installation, drilling and related research work for the realization of petroleum production have been completed.
- o Production. The production period begins when commercial operations start 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:

- o drilling a minimum number of exploration wells;
- o producing a fixed amount of seismic data; and
- o 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 area, to CNOOC at the end of each of the third year and fifth year 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

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

61

X multiplied by 32.5% represents remainder oil distributed according to each partner's participating interest. (3)

- (1) 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%.
- (2) The ratio "X" is agreed in each production sharing contract based on commercial considerations and ranges from 8% to 100%.
- (3) See "--Principal Oil and Gas Regions" for our participating interest percentage in each production sharing contract.

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)

-----  
Less than 1 million tons.....  
1-1.5 million tons.....  
1.5-2.0 million tons.....  
2.0-3.0 million tons.....  
3.0-4.0 million tons.....  
Above 4 million tons.....

-----

(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:

- o recovery of operating costs incurred by the partners during the year;
- o recovery of exploration costs, excluding interest accrued thereon, incurred but not yet recovered by foreign partners during the exploration period; and
- o 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 contract. 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 an estimated production tax and royalty to the PRC government each time we ship crude oil production, or on a monthly basis for natural gas production. At the end of each annual period, we calculate the production tax and royalty payable for the year and file this information with the PRC tax bureau. 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:

- o preparing work programs and budgets;



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- o procuring equipment and materials relating to operations;
- o establishing insurance programs; and
- o 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:

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

Daily operations of a property subject to the respective 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 us have joint ownership in all of the assets purchased, installed or constructed under the production sharing contract until either:

- o the foreign partners have fully recovered their development costs, or
- o 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 us 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

63

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 gasfield, 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 2004, we provided for dismantlement costs of approximately Rmb 201.6 million.

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 overseas countries, including Indonesia, Australia, Morocco and Myanmar.

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 whereby such companies explore and develop oil and gas in specified areas in exchange for a percentage interest in the production from the fields in the applicable production sharing area. 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:

- o contractors are responsible for all investments (exploration, development and production);
- o a contractor's investment and production costs are recovered against production;
- o the profit split between the Indonesian government and contractors is based on production after the cost recovery

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portion;

- o ownership of tangible assets remains with the Indonesian government; and
- o 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

64

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%

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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 Morocco and Myanmar. On May 3, 2004, we, through our wholly owned subsidiary CNOOC Morocco Limited, acquired from Vanco Energy Corporation a 11.25% interest in a petroleum agreement for Ras Tafelney offshore Morocco. At the end of 2004, we and 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. 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 as well as independently and through production sharing contracts. As of December 31, 2004, we were not a party to any geophysical survey agreements, 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

65

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.

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### 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, 2004, we paid an annual insurance premium of approximately Rmb 132 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, 2004, 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 three years ended December 31, 2002, 2003 and 2004, we paid approximately Rmb 110 million, Rmb 56 million and Rmb 8 million, respectively, to CNOOC Research Center for its provision of general research and development services.

Our research efforts have focused on:

- o advanced resolution enhancement technology;
- o building up exploration and development data bases to improve the efficiency of our research efforts; and
- o consolidating multi-discipline data to optimize the selection of exploration sites.

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

- o building more accurate reservoir models;
- o re-processing existing seismic and log data to locate potential areas near existing fields to be integrated into existing production facilities; and
- o 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. For joint exploration and production with foreign enterprises, we are required to obtain various governmental approvals, through CNOOC, including those from:

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

Although our sales are coordinated by the National Development and Reform Commission, historically we have been given flexibility to sell our crude oil based on the international spot price and to determine where we sell our crude oil.

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

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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:

67

- o 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;
- o 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;
- o 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
- o production from one of our major gasfields, 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 the five years ended December 31, 2004 represented approximately 6.7%, 7.3%, 5.6%, 3.6% and 3.2%, 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 you 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 exploration 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.

68

#### 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 the local PRC 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, 2004, we did not experience any incident of crude oil discharge.

The PRC environmental laws do not currently 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, 2002, 2003 and 2004 of approximately Rmb 126.1 million, Rmb 167.3 million and Rmb 201.6 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



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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, 2004. 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

69

Transactions--Lease agreement in respect of the Nanshan Terminal," and "--Lease and property management services."

We own the following 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; and
- o a parcel of land at Suizhong 36-1 Base, Xiaoli Huang Village, Gaoling Town, Suizhong County, Liaoning Province.
- o land, various buildings and structures located at Bonan Processing Plant, Jimu Island, Longgang Development Zone, Longkou city, Shandong Province.

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

### Employees and Employee Benefits

During the years ended December 31, 2002, 2003 and 2004, we employed 2,047 persons, 2,447 persons and 2,524 persons, respectively. Our number of employees increased in 2003 mainly due to the establishment of our research center, CNOOC (China) Limited Research Center, in July 2003. Of the 2,524 employees we employed as of December 31, 2004, approximately 69.8% were involved in petroleum exploration, development and production activities, approximately 7.3% 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:

- o protects employees' rights;
- o organizes educational programs;
- o assists in the fulfillment of economic objectives;
- o encourages employee participation in management decisions; and
- o 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

70

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.

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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.

For further details regarding retirement benefits, see note 30 to our consolidated financial statements attached to this annual report.

### Health, Safety and Environmental Policy

We place much importance on our health, safety and environmental, or HSE, policy. In 2002, we implemented an overall HSE management system in each of our production divisions offshore China and established an HSE policy for our overseas operations. We review the management performance of each of our production divisions every other year to improve our HSE management. The HSE policy for our operations offshore China focuses on increasing our employees' awareness of health, safety and environmental issues in the workplace. The HSE policy for our overseas operations includes setting annual safety targets, conducting year-end evaluations, creating emergency contact lists, recording incidents accurately. We regularly organize training courses and conduct environmental and safety drills. We also closely monitor weather forecasts and track hazardous weather conditions that may affect our production facilities.

In 2002, we established a "System for Determining Accountability in the Event of a Major Production Accident," and implemented an "Evaluation System for Health, Safety and Environmental Protection." We also launched a "Safety Activity of the Month" program and, together with our production sharing contract partners, hired a foreign professional to conduct safety inspections on the helicopters used in our operations offshore China.

In 2003, we established health management systems for our offshore crew members, developed our crisis management procedures, and launched the International Association of Oil & Gas Producers (OGP) HSE management system as a commitment to the safety of our contractors.

In 2004, we improved our crisis management procedures and further strengthened general on-site safety management as well as safety procedures for high risk activities such as those involving helicopter, diving and loading operations. We have also developed a computerized healthcare management system, which allows us to assign duties based on the health conditions of our employees in a more efficient manner.

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 2004, 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 Awareness Plan" organized by the State Oceanic Administration. In 2004, 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 awareness 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. In 2004, as the only OGP member in China, we assisted OGP in organizing its thirtieth anniversary seminar in China.

In 2004, we recorded no major fatalities, contaminations or any safety related liabilities that exceeded US\$120,000 per incident. According to our OSHA statistics, we achieved an above-average rating as compared with other major international oil companies.

#### 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 2004, we held 641 training workshops, which were attended by 8,816 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. We have established an employee performance evaluation system. In 2004, we also introduced a performance-based appraisal system for our branch offices. These evaluation systems aim at linking the development objectives of the individual employees and branch offices with our overall operating targets.

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

### 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 37 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." On June 6, 2002, we terminated our engagement with Arthur Andersen & Co, our independent public accountants prior to such date. For a discussion of the change of accountants, see "--Change of Accountants" and "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."

#### 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

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company permitted to conduct exploration production activities with international oil and gas companies offshore China. As of December 31, 2004, we had estimated net proved reserves of 2,230.0 million BOE, comprised of 1,455.6 million barrels of crude oil and condensate and 4,646.6 billion cubic feet of natural gas. For the year 2004, our net production averaged 319,436 barrels per day of crude oil, condensate and natural gas liquids and 364.1 million cubic feet per day of natural gas, which together totaled 382,513 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.

72

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,			
	2000	2001	2002	2003
Net production of crude oil, condensate and natural gas liquids (BOE/day).....	206,347	228,874	298,625	306,625
Net production of natural gas (mmcf/day).....	197.9	195.0	272.6	299.0
Net income (Rmb in millions).....	10,296.6	7,957.6	9,232.8	11,533.8

We sell 45.4% of our crude oil production in 2004 to customers affiliated with Sinopec or PetroChina in the PRC domestic market. We sell 37.8% of our natural gas production offshore China in 2004 to Castle Peak Power Company Limited 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 26 to our consolidated financial statements attached to this annual report.

Before the reorganization, certain PRC subsidiaries of CNOOC provided various materials, utilities and ancillary services for CNOOC's exploration

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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 subsidiaries. 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 CNOOC 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 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

73

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 addition, we entered into a repurchase agreement whereby put options and call options are granted to us and the sellers, respectively, to sell or to repurchase the interests in the above-mentioned PSCs. The options are exercisable if:

- o the LNG supply contract is terminated due to the non-satisfaction of the conditions precedent to the LNG supply contract on or before December 31, 2004; or
- o the LNG supply contract is otherwise legally ineffective on or before December 31, 2004.

These put options and call options have lapsed since neither of the

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above circumstances occurred on or before December 31, 2004.

In July 2003, we increased our interest in Qinhuangdao 32-6, a PSC oilfield in Bohai Bay, from 51% to 75.5% by acquiring a 24.5% interest in the oilfield from BP China Exploration and Production Company for a cash consideration of US\$150 million, plus working capital adjustments.

In July 2003, we acquired the remaining 49% interest in Liuhua 11-1, a PSC oilfield in Eastern South China Sea, from BP China Exploration and Production Company and Kerr-McGee China Petroleum Limited, for a total cash consideration of US\$40 million, plus working capital adjustments.

In 2003, we invested Rmb 450 million in the equity interest of CNOOC Finance Corporation Limited, or CNOOC Finance, a subsidiary of our controlling shareholder, CNOOC. Our investment represented 31.8% of the registered capital of CNOOC Finance.

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.

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

74

At the end of 2004, we and 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. 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.

Production Sharing Contracts Offshore China

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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." For the years ended December 31, 2002, 2003 and 2004, the percentage of foreign partners' oil that was resold by us in the PRC market amounted to approximately 50%, 69% and 70%, respectively. The foreign partners sold the remaining portion of their oil in the international markets.

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 7 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, in 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.



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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 53.9%, 52.7% and 49.6%, respectively, for the years ended December 31, 2002, 2003 and 2004, respectively. Although 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, "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, 2002, 2003 and 2004 were Rmb 26.1 million, Rmb 167.3 million and Rmb 201.6 million, respectively. The accrued liability is reflected in our consolidated balance sheet under "provision for dismantlement." See note 27 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

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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 years ended December 31, 2002, 2003 and 2004, 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

76

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, Land and Buildings

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.

Land and buildings represent our onshore buildings and our land use rights which are stated at valuation less accumulated depreciation and accumulated impairment losses. Professional valuations are performed periodically, our last valuation was performed on December 31, 2000. In intervening years, our directors review the carrying value of land and buildings and make adjustment where in their opinion there has been a material change in value. Any increase in land and building valuation is credited to the revaluation reserves; any decrease is first offset against an increase in

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an earlier valuation in respect of the same property and is thereafter charged to the income statement. Depreciation is calculated on the straight-line basis at an annual rate estimated to write off the valuation of each asset over its expected useful life, ranging from 30 to 50 years.

### 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.

77

### 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 site by site basis, in respect of our expected dismantlement 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

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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,			
	2002		2003	
	(Rmb in millions, except percentages, production			
<b>Revenues:</b>				
<b>Oil and gas sales: (1)</b>				
Crude oil.....	21,498	81.5%	25,792	63.0%
Natural gas.....	2,281	8.7	2,325	5.7
<b>Total oil and gas sales.....</b>	<b>23,779</b>	<b>90.2%</b>	<b>28,117</b>	<b>68.7%</b>
Marketing revenues.....	2,377	9.0%	12,398	30.3%
Other income.....	217	0.8	435	1.1
<b>Total revenues.....</b>	<b>26,374</b>	<b>100.0%</b>	<b>40,950</b>	<b>100.0%</b>
<b>Net production (million BOE):</b>				
Crude oil.....	109.0	86.2%	111.9	85.9%
Natural gas.....	17.5	13.8	18.3	14.1

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Total net production.....	126.5	100.0%	130.2	100.0%
	=====	=====	=====	=====
Average net realized prices:				
Crude oil (per bbl).....	US\$24.35		US\$28.11	
Natural Gas (per mcf).....	2.98		2.87	

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

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	
	2002	2003
	-----	-----
Operating Revenues:		
Oil and gas sales.....	90.2%	68.7%
Marketing revenues.....	9.0	30.2
Other income.....	0.8	1.1
	-----	-----
Total revenues.....	100.0%	100.0%
	=====	=====
Expenses:		
Operating expenses.....	(14.3)%	(11.0)%
Production taxes.....	(3.9)	(3.0)
Exploration costs.....	(5.0)	(2.1)
Depreciation, depletion and amortization.....	(15.2)	(11.3)
Dismantlement .....	(0.5)	(0.7)
Crude oil and product purchases.....	(8.8)	(30.0)
Selling and administrative expenses.....	(3.8)	(3.1)
Other.....	(0.1)	(0.9)
	-----	-----
	(51.6)%	(61.7)%
	-----	-----
Interest income.....	0.5%	0.4%
Interest expenses.....	(1.1)	(0.9)
Exchange gain (loss), net.....	(0.4)	(0.0)
Short term investment income.....	0.7	0.3
Share of profit of an associate.....	0.6	0.5
Non-operating profit (loss), net.....	(0.3)	0.8
	-----	-----
Income before tax.....	48.4	39.5
Tax.....	(13.4)	(11.3)
	-----	-----
Net income.....	35.0%	28.2%
	=====	=====

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

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attached to this annual report. With respect to revenues derived

79

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. This surcharge no longer exists. 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

82

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

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"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.

### 2004 versus 2003

#### Consolidated Net Profit

Our consolidated net income after tax was Rmb 16,185.8 million (US\$1,955.6 million) in 2004, an increase of Rmb 4,650.3 million (US\$561.9 million), or 40.3%, from Rmb 11,535.5 million in 2003.

#### Revenue

80

Our oil and gas sales for the year 2004 were Rmb 36,886.0 million (US\$4,456.7 million), an increase of Rmb 8,769.2 million (US\$1,059.5 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 gasfields.

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 (US\$27.5 million), an increase of Rmb 124.5 million (US\$15.0 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 (US\$8.6 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 (US\$11.9 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 (US\$612.6 million) in 2004, an increase of Rmb 557.5 million (US\$67.4 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 (US\$4.4) per BOE in 2004, an increase of 4.2% from Rmb 35.2 (US\$4.3) per BOE

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in 2003. Operating expenses offshore China in 2004 were Rmb 29.9 (US\$3.6) per BOE, an increase of 10.7% from Rmb 27.0 (US\$3.3) per BOE in 2003. Operating expenses offshore Indonesia were Rmb 88.7 (US\$10.7) per BOE, an increase of 15.6% from Rmb 76.7 (US\$9.3) 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 our profit sharing model. Based on working interest production, operating expenses offshore Indonesia in 2004 were Rmb 42.0 (US\$5.1) per BOE, which were in line with the operating expenses offshore Indonesia in the previous year.

Production taxes. Our production taxes for the year 2004 were Rmb 1,725.7 million (US\$208.5 million), an increase of Rmb 487.1 million, or 39.3%, (US\$58.9 million) 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 the year 2004 were Rmb 1,316.2 million (US\$159.0 million), an increase of Rmb 468.1 million (US\$56.6 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 (US\$18.8 million).

Depreciation, depletion and amortization expenses. Our depreciation, depletion and amortization expenses for 2004 were Rmb 5,455.1 million (US\$659.1 million), an increase of Rmb 812.3 million (US\$98.1 million), or 17.5%, from Rmb 4,642.8 million in 2003. On a unit of production basis, depreciation, depletion and amortization expenses for the year 2004 were Rmb 39.5 (US\$4.8) 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.

81

Dismantlement costs. Our dismantlement costs for the year 2004 were Rmb 201.6 million (US\$24.4 million), an increase of Rmb 34.3 million (US\$4.1 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 (US\$0.2) 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 the year 2004 were Rmb 1,057.7 million (US\$127.8 million), a decrease of Rmb 154.8 million (US\$18.7 million), or 12.8%, from Rmb 1,212.5 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 7.6 (US\$0.9) per BOE in 2004, a decrease of 19.1% from Rmb 9.4 per BOE in 2003. Our selling and administrative expenses in China in 2004 were Rmb 5.5 (US\$0.7) per BOE, a decrease of 17.5% from 2003.

Net interest expenses/income



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Our net interest expense for 2004 was Rmb 235.0 million (US\$28.4 million), an increase of Rmb 63.6 million (US\$7.7 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 (US\$11.5 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 (US\$3.5 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 (US\$8.7 million), a decrease of Rmb 51.1 million (US\$6.2 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 the year 2004 was Rmb 344.5 million (US\$41.6 million), an increase of Rmb 124.2 million (US\$15.0 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 the year 2004 was Rmb 519.2 million (US\$62.7 million), compared to non-operating income of Rmb 315 million for the year 2003. In 2004, the net non-operating income was mainly due to the tax refund from re-investment in China.

### Tax

Our taxation for the year 2004 was Rmb 6,930.8 million (US\$837.4 million), an increase of Rmb 2,303.0 million (US\$278.3 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 30.3%, as compared with the effective rate of 28.6% in 2003.

82

## 2003 versus 2002

### Consolidated Net Profit

Our consolidated net income after tax was Rmb 11,535.5 million in 2003, an increase of Rmb 2,302.7 million, or 24.9%, from Rmb 9,232.8 million in 2002.

### Revenue

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Our oil and gas sales for the year 2003 were Rmb 28,116.8 million, an increase of Rmb 4,337.5 million, or 18.2%, from Rmb 23,779.3 million in 2002. The increase primarily reflects the rise in global crude oil prices and our production level. In 2003, as a result of the commencement of production in our new oil and gas properties as well as our successful acquisition of a portion of interests in Liuhua 11-1 and Qinhuangdao 32-6, our production volume increased compared to 2002. The average net production volume per day was 356,729 barrels in 2003, compared to 346,639 barrels in 2002, an increase of 3%. In 2003, with the higher-than-expected oil price, our Indonesian oil and gas operations had a lower-than-expected net production volume based on the Indonesian oil production sharing contract, which affected the production volume growth. Our crude oil sales prices are determined in accordance with international crude oil prices. The international oil price in 2003 rose sharply compared with 2002. The average realized price for our crude oil was US\$28.11 per barrel in 2003, an increase of US\$3.76, or 15.4% from US\$24.35 per barrel in 2002. The average realized price of natural gas was US\$2.87 per thousand cubic feet in 2003, a decrease of US\$0.11, or 3.7%, from US\$2.98 per thousand cubic feet in 2002. The decrease was due to the lower natural gas price of our Indonesian properties and the Dongfang gasfield.

In 2003, our net marketing profit, which were derived from marketing revenue less purchase cost of crude oil and oil products, were Rmb 103.4 million, an increase of Rmb 52.3 million, or 102.3%, from Rmb 51.1 million in 2002. 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 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.

Our other income, reported on a net basis, was derived from our other income less corresponding costs. In 2003, the total other income was Rmb 84.5 million, a decrease of Rmb 101.7 million from Rmb 186.2 million in 2002, resulting primarily from the decrease in project management fees.

### Expenses

Operating expenses. Our operating expenses were Rmb 4,512.8 million in 2003, an increase of Rmb 737.5 million, or 19.5%, from Rmb 3,775.3 million in 2002. The increase primarily resulted from operating expenses in connection with the Indonesian oil and gas properties, which were based on a full year's consolidated accounts as compared to the nine months contributions in 2002, and the commencement of operations in new properties. Operating expenses were Rmb 35.1 per BOE in 2003, which were higher than operating expenses of Rmb 30.3 per BOE in 2002. The increase was, on the one hand, attributable to the higher operating expenses on a unit of production basis for the Indonesian oil and gas properties, resulting from the higher-than-expected oil price and lower net production, and its increased weighting in us on an annual production basis. On the other hand, the natural diminishing in old oilfield production and the higher maintenance cost also resulted in the slight increase in unit cost.

Production taxes. Our production taxes for the year 2003 were Rmb 1,238.6 million, an increase of Rmb 215.6 million, or 21.1%, from Rmb 1,023.0 million in 2002. The increase was due to increase in oil and gas sales in 2003.

Exploration costs. Our exploration costs for the year 2003 were Rmb 848.1 million, a decrease of Rmb 470.2 million, or 35.7%, from Rmb 1,318.3 million in 2002. The decrease primarily resulted from a higher successful rate of exploration and drilling activities.

Depreciation, depletion and amortization expenses. Our depreciation, depletion and amortization expenses for 2003 were Rmb 4,642.8 million, an increase of Rmb 623.3 million, or 15.5%, from Rmb 4,019.5 million in 2002. On a unit of production basis, depreciation, depletion and amortization expenses for the year 2003 were Rmb 36.2 per BOE, an increase of 12.0% compared to Rmb 32.3 per BOE in 2002. The primary reason for the increase was the higher weighting for Indonesian oil and gas properties, which had a higher amortization cost, and the increase in amortization cost resulted from the reserve adjustment of some old fields.

Dismantlement costs. Our dismantlement costs for the year 2003 were Rmb 167.3 million, an increase of Rmb 41.2 million, or 32.7%, from Rmb 126.1 million in 2002. 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 1.3 per BOE, an increase of 30.0% compared to Rmb 1.0 per BOE in 2002. The increase was primarily due to an upward revision of the estimated dismantlement costs and the increase in dismantlement costs resulting from the reserve adjustment of some old fields.

Selling and administrative expenses. Our selling and administrative expenses for the year 2003 were Rmb 1,212.5 million, an increase of Rmb 206.0 million, or 20.5%, from Rmb 1,006.5 million in 2002. The primary reason for the increase was the selling and administrative expenses incurred in connection with the Indonesian oil and gas properties. On a unit of production basis, selling and administrative expenses were Rmb 9.4 per BOE in 2003, an increase of 16.0% from Rmb 8.1 per BOE in 2002. The increase was primarily attributable to the higher selling and administrative expenses on a unit of production basis for the Indonesian oil and gas properties, resulting from the higher-than-expected oil price and lower net production, and its increased weighting in us on an annual production basis. Our selling and administrative expenses in China in 2003 were Rmb 6.6 per BOE, in line with the previous year.

#### Net interest expenses/income

Our net interest expense for 2003 was Rmb 171.4 million, in line with the net interest expense of Rmb 146.9 million in 2002.

#### Exchange Gain/Loss, net

Our exchange loss for 2003 was Rmb 6.7 million, a decrease of Rmb 107.1 million when compared with an exchange loss of Rmb 113.8 million in 2002. The loss in 2002 was mainly attributable to exchange rate fluctuations related to our yen-denominated loans. Since we have prepaid a large portion of yen-denominated loans on December 27, 2002, and the outstanding amount of our yen-denominated loans is hedged using foreign currency swaps, we do not expect similar exchange gains or losses for that portion. Therefore, the exchange gain or loss this year was primarily attributable to the exchange gain generated from day-to-day operating activities.

#### Short Term Investment Income

Our short term investment income for 2003 was Rmb 123.5 million, a decrease of Rmb 69.8 million or 36.1% from Rmb 193.3 million in 2002. The decrease was primarily due to a decline in short term investment return in 2003.

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### Share of Profit of an Associate

Our share of profit of an associate for the year 2003 was Rmb 220.3 million, an increase of Rmb 54.9 million, or 33.2%, from Rmb 165.4 million in 2002. This item reflected our share of profit generated by Shanghai Petroleum and Natural Gas Company Limited. This company experienced an increase of profit in 2003 resulting from increases in production and oil prices.

### Non-operating Income/Expenses, Net

84

Our net non-operating income for the year 2003 was Rmb 315.0 million, compared to non-operating expense for the year 2002 of Rmb 71.4 million. In 2003, the net non-operating income was mainly due to the tax refund from re-investment.

### Tax

Our taxation for the year 2003 was Rmb 4,627.8 million, an increase of Rmb 1,086.4 million, or 30.7%, from Rmb 3,541.4 million in 2002. The primary reason for the increase was the increase in profit before tax. The effective tax rate for 2003 was 28.6%, slightly higher than the effective rate of 27.7% in 2002.

## B. LIQUIDITY AND CAPITAL RESOURCES

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

	Year ended December 31,	
	2002	2003
	(Rmb in millions)	
Cash provided by (used for):		
Operating activities.....	14,742	17,819
Investing activities.....	11,724	(9,513)
Financing activities.....	(1,573)	(1,745)
	1,445	6,561
Net increase/(decrease) in cash and cash equivalents.....	1,445	6,561

### Cash Provided by Operations

Cash provided by operations in 2004 amounted to Rmb 22,327.9 million (US\$2,697.7 million), an increase of Rmb 4,509.1 million (US\$544.8 million), or 25.3%, from Rmb 17,818.7 million in 2003. In addition to an increase in profit before tax of Rmb 6,953.3 million (US\$840.1 million), the increase in cash provided by operations was also due in part to an increase in depreciation, depletion and amortization expenses of Rmb 812.3 million (US\$98.1 million), an increase in dismantlement costs of Rmb 34.3 million (US\$4.1 million), and an increase in loss on disposal of fixed assets and

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write-off of exploration properties totaling Rmb 116.1 million (US\$14.0 million).

The increase was partially offset by a net increase in income taxes of Rmb 3,887.5 million (US\$469.7 million), an increase in our share of income of associated companies of Rmb 124.2 million (US\$15.0 million), an increase in net interest expenses of Rmb 63.6 million (US\$7.7 million), an increase in net exchange gain of Rmb 36.0 million (US\$ 4.3 million), the provision for inventory obsolescence of Rmb 11.5 million (US\$1.4 million), and a decrease in gains in short term investment and others of Rmb 55.0 million (US\$ 6.6 million).

In addition, operating cash flows increased in 2004 due to decreases in current liabilities from operating activities of Rmb 332.1 million (US\$40.1 million) and in current assets excluding cash and bank balances of Rmb 1,031.7 million (US\$124.7 million). See note 31 to our consolidated financial statements attached to this annual report.

Cash provided by operations in 2003 amounted to Rmb 17,818.7 million, an increase of Rmb 3,076.7 million, or 20.9%, from Rmb 14,742.0 million in 2002. In addition to an increase in profit before tax of Rmb 3,389.1 million, the increase in cash provided by operations was also due in part to adjustments related to an increase in depreciation, depletion and amortization expenses of Rmb 623.2 million, an increase in dismantlement costs of Rmb 41.2 million, provision of inventory obsolescence of Rmb 8.7 million, a decrease in return on short-term investments and amortization of a discount for long-term guaranteed notes of Rmb 75.0 million, and an increase in net interest of Rmb 24.4 million.

The increase was partially offset by a net increase in income taxes of Rmb 668.6 million, the

85

growth in our share of income of associated companies of Rmb 54.9 million, a decrease in exchange loss of Rmb 107.1 million, and a decrease in loss on disposal and write-off of property, plant and equipment of Rmb 398.0 million.

In addition, operating cash flows increased in 2003 due to an increase in current liabilities from operating activities of Rmb 935.0 million, and a simultaneous decrease in current assets excluding cash and bank balances of Rmb 800.7 million. See note 31 to our consolidated financial statements attached to this annual report.

### Capital Expenditures and Investments

In line with our use of the successful efforts method of accounting, total capital expenditures and investments primarily include successful exploration and development expenditures for oil and gas properties. Total capital expenditures were Rmb 18,622.0 million (US\$2,250.0 million) in 2004, an increase of Rmb 6,249.5 million (US\$755.1 million), or 50.5%, from Rmb 12,372.5 million in 2003. The capital expenditure in 2004 included Rmb 783.5 million (US\$94.7 million) for capitalized exploration activities, Rmb 12,059.4 million (US\$1,457.1 million) for development activities, and Rmb 5,779.1 million (US\$698.2 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 (US\$758.8 million), which

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was partially offset by cash inflow from net disposal of short-term investment of Rmb 294.8 million (US\$35.6 million).

Total capital expenditures were Rmb 12,372.5 million in 2003, an increase of Rmb 805.6 million, or 7.3%, from Rmb 11,566.9 million in 2002. The capital expenditure in 2003 included Rmb 524.0 million for capitalized exploration activities, Rmb 7,747.6 million for development activities, and Rmb 4,100.9 million for acquiring the Tangguh LNG project, Qinhuangdao 32-6 and Liuhua 11-1 rights. Our development expenditures in 2003 related principally to the development of Bozhong 25-1, Bonan, Weizhou 12-1 North, Dongfang 1-1, CFD11-1, Panyu 4-2/5-1 and Huizhou 19-2/19-3.

Our total capital expenditures for general exploration and development activities for 2004 were approximately US\$1,686.4 million. For the year 2005, we have budgeted approximately US\$2.1 billion for capital expenditures, approximately US\$220.9 million of which is budgeted for general exploration activities offshore China, approximately US\$1,624.1 million of which is budgeted for development activities offshore China and approximately US\$207.5 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,	
	2004 (1)	2005 (2)
	(US\$ in millions)	
Operating Area:		
Bohai Bay		
Development.....	762.2	804.5
Exploration.....	74.4	79.9
Western South China Sea		
Development.....	91.5	225.7
Exploration.....	68.9	45.4
East China Sea		
Development.....	161.2	86.3
Exploration.....	16.9	19.5
East South China Sea		
Development.....	358.6	507.6
Exploration.....	52.5	62.2
Other Offshore China		
Development.....	--	21.7
Exploration.....	5.6	27.9
Overseas		
Development.....	78.0	207.5
Exploration.....	16.6	43.6
Total.....	1,686.4	2,131.8
	=====	=====

86

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- (1) Figures for 2004 represent our actual spending for capital expenditure purposes.
- (2) Figures for 2005 represent our budgeted capital expenditures.

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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. For example, the above budgeted amounts do not include any investments we may make in the liquefied natural gas project located in Guangdong Province, other natural gas projects and overseas natural gas properties. 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

In December 2004, through our wholly owned finance subsidiary, CNOOC Finance (2004) Limited, we issued US\$1 billion zero coupon guaranteed convertible bonds due 2009. The bonds are guaranteed by us and convertible to our shares at the holders' choice at an initial conversion price of HK\$6.075 per share between January 15, 2005 and November 15, 2009. On June 7, 2005, the conversion price of was adjusted to HK\$5.97 per share pursuant to the terms of the convertible bonds as a result of our distribution of a final dividend and a special final dividend for the year ended December 31, 2004. Unless previously converted, redeemed or purchased and cancelled, the bonds will be redeemed at 105.114% of their principal amount on December 15, 2009.

We had net cash inflows from financing activities of Rmb 1,970.5 million (US\$238.1 million) in 2004, primarily attributable to the convertible bond issuance which generated cash inflow of approximately Rmb 8,154.1 million (US\$985.2 million). The cash inflows were partially offset by our repayment of Rmb 21.1 million (US\$2.5 million) in bank loans, dividend distributions of Rmb 6,101.4 million (US\$737.2 million) and a cash outflow of Rmb 61.2 million (US\$7.4 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, 2004. As of the date this annual report is filed, we have not incurred any material long-term debt since December 31, 2004.

87

	Debt maturities (principal only)			
Due by December 31,	Original currency			Total Rmb
	US\$	JPY	Rmb	equivalents

(in millions, except percentages)

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2005.....	--	271.5	--	24.3
2006-2008.....	100.0	542.9	--	865.2
2009-2010.....	983.1	--	--	8,156.4
2011 and beyond.....	981.1	--	--	8,157.2
Total.....	2,064.2	814.4	--	17,203.1
Percentage of total debt.....	99.3%	0.7%	--	100.0%

As of June 8, 2005, we had a total U.S. dollar debt of US\$2,064.2 million and a total foreign currency debt of US\$2,078.5 million.

We had net cash outflows from financing activities of Rmb 1,744.9 million in 2003, resulting primarily from our repayment of Rmb 336.9 million in bank loans, dividend distributions of Rmb 5,403.7 million. This cash outflow was offset by cash inflow of Rmb 3,995.8 million resulting from our May 2003 offering of US\$200 million in 4.125% guaranteed notes due 2013 and US\$300 million in 5.5% guaranteed notes due 2033.

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 2001, 2002 and 2003, we declared and paid dividends totaling Rmb 871.1 million, Rmb 2,265.1 million and Rmb 5,403.7 million, respectively. In 2004, we declared dividends totaling Rmb 6,101.4 million (US\$737.2 million) and paid dividends totaling Rmb 6,091.4 million (US\$736.0 million). The difference between the amount of dividends declared and paid in 2004 was because that we repurchased and canceled some of our shares in 2004. Out of the total dividends declared and paid in 2004, Rmb 2,617.5 million (US\$316.3 million) was attributable to a special interim dividend to replace the 2003 final dividend and final special dividend proposed by our board of directors in 2003. On May 25, 2005, we declared a final dividend of Rmb 3,493.4 million (US\$422.1 million) for fiscal year 2004, which was paid in full on June 7, 2005. 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 2005. 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:

- o 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.
- o 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 and the People's Bank of China, depending on the type of international financing raised. We may also need to



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obtain PRC government support for any project involving significant capital investment in the operations of our PRC subsidiary.

88

- o 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.

For the years ended December 31, 2002, 2003 and 2004, our retirement

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expenses attributed to the current government plans were Rmb 7.0 million, Rmb 15.5 million and Rmb 30.3 million (US\$3.7 million), respectively.

### 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 of 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

89

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 inflation rate, as represented by the general consumer price index, of 0.8% in 2002, an overall deflation rate of 1.2% in 2003 and an overall inflation rate of 3.9% in 2004. Neither the deflation nor the inflation have 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 revaluation of properties and land use rights performed in connection with the reorganization, the treatment of impairment of long-lived assets, the treatment of stock compensation plans, the treatment of unrealized holding gains from available-for-sale investments in marketable securities and the provision for dismantlement liabilities. Except for the accounting treatment of the property revaluation and the recognition of stock compensation costs, the unrealized holding gains from available-for-sale investments in marketable securities and the provision for dismantlement liabilities, there are no material differences between Hong Kong GAAP and U.S. GAAP that affect our net income or shareholders' equity. See note 37 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

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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%. Moreover, entities now comprising our PRC subsidiary were exempted from enterprise income taxes for two years starting from the first year of profitable operation in 1996 and were entitled to a 50% reduction of enterprise income taxes for three years beginning in 1998 and ending on December 31, 2000. This tax exemption increased our earnings by Rmb 1,920.7 million during the year ended December 31, 2000. Since January 1, 2001, the PRC subsidiary has been subject to the 30% enterprise income tax rate. 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:

- o production taxes equal to 5% of independent production and production under production sharing contracts; and
- o 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 year presented.

90

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 and 2004, we had Rmb 5,783.2 million and Rmb 6,688.5 million (US\$808.1 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 for the year ended December 31, 2001 attached to this annual report. 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

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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 three-year period ended December 31, 2002, 2003 and 2004 included in this annual report.

### Recent Accounting Pronouncements

#### U.S. GAAP

Statements of Financial Accounting Standards No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets," were issued by the Financial Accounting Standards Board in June 2001 and became effective for us on July 1, 2001 and January 1, 2002, respectively. In 2003, the Emerging Issues Task Force (EITF) considered the issue of whether FAS 141 and 142 require interests held under oil, gas and mineral leases to be separately classified as intangible assets on the balance sheets of companies in the extractive industries. If such interests were deemed to be intangible assets by the EITF, mineral rights to extract oil and gas for both undeveloped and developed leaseholds would be classified separately from oil and gas properties as intangible assets on the corporation's balance sheet. Historically we have capitalized the acquisition cost of oil and gas properties interests in accordance with statement of Financial Accounting Standard No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies". In addition, in line with industry practice, we have reported these assets as part of property, plant and equipment.

In 2004, the EITF reached a conclusion that mineral rights are tangible assets and the balance sheet classification and disclosures for drilling and mineral rights of oil and gas producing entities are within the scope of Statement of Financial Accounting Standard No.19, "Financial Accounting and Reporting by Oil and Gas Producing Companies." The EITF conclusion has no implication to us as we currently account for our oil and gas properties in accordance with the EITF conclusion.

The Financial Accounting Standards Board (FASB) has proposed an amendment to Statement No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" (FAS No. 19) that may change the way oil and gas producers account for deferred exploratory drilling costs. Under the current rules, there is a presumption that all exploratory drilling costs will be expensed within one year following completion of drilling if proved reserves have not been recorded, except for costs related to

areas where additional exploration wells are necessary to justify development plans and such additional wells are under way or firmly planned for the near future.

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." The FASB staff has developed indicators to help determine

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whether sufficient progress is being made. We believe the adoption of the proposed amendment (once finalized) will have no impact on our consolidated financial position or results of operations.

In December 2004, the Financial Accounting standards Board, or 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. We believe the adoption of this statement will have no impact on 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 Securities and Exchange Commission's rules, FAS No. 123R is now effective for us beginning January 1, 2006. The pro forma disclosures previously permitted under FAS No. 123 will cease to be an alternative to financial statement recognition. We believe the adoption of the FAS No. 123 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 May 2003, the FASB issued FAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity," to address the balance sheet classification of certain financial instruments that have characteristics of both liabilities and equity. This statement, already effective for contracts created or modified after May 31, 2003, was originally intended to become effective July 1, 2003, for all contracts existing on May 31, 2003. However, on November 7, 2003, the FASB issued an indefinite deferral of certain provisions of FAS No. 150. We will continue to monitor and assess the FASB's modifications of FAS No. 150, but do not anticipate any material impact on our financial position and results of operations.

Hong Kong

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, which we collectively referred to in this annual report as the new HKFRSs. The new HKFRSs are generally effective for accounting periods beginning on or after January 1, 2005. We have not early adopted these new HKFRSs in the financial statements for the year ended December 31, 2004. We have already commenced an assessment of the impact of these new HKFRSs, but are not yet in a position to state when these new HKFRSs would have a significant impact on our results of operations and financial position.

C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.

See "Item 4--Information on the Company--Business Overview--Research and Development" and "Item 7--Major Shareholders and Related Party Transactions--Related Party Transactions--Categories of Connected Transactions--Research and Development Services."

D. TREND INFORMATION

Crude oil price is a major driver of our results of operation. We price our crude oil with reference to the international crude oil prices, which have fluctuated considerably over the years. On January 1,

2004 the international benchmark crude oil, West Texas Intermediate, was US\$32.52 per barrel. As of June 8, 2005, it was US\$52.54 per barrel. In addition, continued political and economic uncertainties in Iraq and threat of terrorism worldwide raise concerns about the security and availability of ample supplies to meet growing demand. It is expected that crude oil price will remain relatively high in 2005. For more information about crude oil prices, see "Item 3--Key Information--Risk Factors--Risks Relating to Our Business--Our business, revenues and profits fluctuate with changes in oil and gas prices," "Item 4--Information on the Company--Business Overview--Sales and Marketing--Sales of Offshore Crude Oil--Pricing," and "Item 5--Operating and Financial Review and Prospects--Operating Results--Results of Operations--2004 versus 2003."

In addition to crude oil, natural gas is becoming an increasingly important part of our business. The Chinese government promotes the use of natural gas as a clean and efficient fuel. Demand for natural gas in the PRC is likely to increase significantly. We have expanded and will continue to expand our natural gas business and intend to exploit our natural reserves to meet growing demand for natural gas. For more information about natural gas, see "Item 3--Key Information--Risk Factors--Risks Relating to Our Business--Any failure to implement our natural gas business strategy may adversely affect our business and financial position," "--The infrastructure and demand for natural gas in the PRC may proceed at a slower pace than our planned increase in production," "Item 4--Information on the Company--Business Overview--Competitive Strengths--Strategic Position in China's Growing Natural Gas Market," and "--Natural Gas Business."

#### E. OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2004, we had a currency swap contract with a financial institution to sell United States dollars in exchange for Japanese Yen in order to hedge certain Japanese Yen denominated loan repayments in the future. The derivative contract was recorded as "Other payable and accrued liabilities" in the consolidated balance sheet at fair value. For the year ended December 31, 2004, we recognized related changes in fair value, a gain of Rmb 2,581,000 (compared to Rmb 10,038,000 in 2003), and included the amount in "Exchange (losses)/gains, net" in the consolidated income statement.

During 2003, we also entered into interest rate swap agreements to partially hedge the fixed-rate debt securities for interest rate risk exposure management purposes with notional contract amount of US\$200 million. The interest rate swap agreements utilized by us effectively modify our exposure to interest risk by converting our fixed-rate debt to a floating rate. These agreements involve the receipt of fixed rate amounts in exchange for floating rate interest payments over the life of the agreement without an exchange of the underlying principal amount. The interest rate swap agreements were settled during the year and the total net gain was Rmb 84,168,000.

#### F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table sets forth information regarding our contractual obligations for the periods indicated.

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Contractual Obligations	Payments due by period		
	Total	Less than 1 year	1-3 years
	Rmb'000	Rmb'000	Rmb'000
Long-term debt obligations.....	17,203,126	24,364	865,212
Operating lease obligations.....	2,606,198	174,184	299,270
Other long-term liabilities reflected on our balance sheet under Hong Kong GAAP .....	3,089,448	--	--
<b>Total.....</b>	<b>22,898,772</b>	<b>198,548</b>	<b>1,164,482</b>

93

As of December 31, 2004, we had the following capital commitments, principally for the construction and purchase of property, plant and equipment:

Capital Commitments	2004	2003
	Rmb'000	Rmb'000
Contracted for.....	9,568,971	2,534,468
Authorized, but not contracted for.....	20,331,504	17,489,791

As of December 31, 2004, we had unutilized banking facilities amounting to approximately Rmb 20,662,120,000 as compared to Rmb 32,455,229,500 in 2003.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

In accordance with Hong Kong law and our articles of association, our affairs are managed by our board of directors. The board of directors has eight members, including four independent non-executive directors.

The table below sets forth information about our directors and senior officers:

Name	Year of Birth	Position
Chengyu Fu.....	1951	Chairman of Board of Directors and Chief Executive Officer
Han Luo.....	1953	Director
Longsheng Jiang.....	1945	Director (resigned on June 1, 2005)
Shouwei Zhou.....	1950	Director and President

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Guangqi Wu.....	1957	Director (since June 1, 2005)
Sung Hong Chiu.....	1947	Independent Non-executive Director
Erwin Schurtenberger.....	1940	Independent Non-executive Director (resign
Kenneth S. Curtis.....	1946	Independent Non-executive Director
Evert Henkes.....	1944	Independent Non-executive Director
Aloysius Hau Yin Tse	1948	Independent Non-executive Director (since
Yunshi Cao.....	1945	Senior Vice President, Company Secretary a
Mark Qiu.....	1964	Chief Financial Officer and Senior Vice Pr as Chief Financial Officer on January 1, 2 Vice President on March 25, 2005 )
Hua Yang.....	1961	Chief Financial Officer (since January 1,

94

Wei Chen.....	1958	Senior Vice President and Director of CNOO Research Center
Guohua Zhang.....	1960	Senior Vice President and General Manager Department
Jian Liu.....	1958	Senior Vice President and General Manager Production Department
Ning Li.....	1964	Senior Vice President and General Manager Project Department

We have a management team with extensive experience in the oil and gas industry. As a result of our cooperation with international oil and gas companies, the management team and staff have had the opportunity to work closely with foreign partners both within and outside China. Such opportunities, in conjunction with management exchange programs with foreign partners, have provided valuable training to our personnel in international management practices. A description of the business experience and present position of each director and executive officer is provided below. Our principal executive offices are located at 65th Floor, Bank of China Tower, One Garden Road, Central, Hong Kong.

Directors

Chengyu Fu received a B.S. degree in geology from the Northeast Petroleum Institute in China and a Master's degree in petroleum engineering from the University of Southern California in the United States. He has over 30 years of experience in the oil industry in the PRC. He previously worked in China's Daqing, Liaohe and Huabei oilfields. He joined CNOOC in 1982 and has since been appointed as the Chairman of the Management Committee formed through a joint venture between CNOOC, BP Amoco, Chevron, Texaco, Phillips



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Petroleum, Shell and Agip. From 1994 to 1995, Mr. Fu was the Deputy General Manager of China Offshore Oil Eastern South China Sea Corporation, a subsidiary of CNOOC. In December 1995, he was appointed Vice President of Phillips China Inc. and General Manager of the Xijiang Development Project. In 1999, Mr. Fu was the General Manager of China Offshore Oil Eastern South China Sea Corporation. In 2000, Mr. Fu was appointed as a Deputy General Manager of CNOOC. Subsequently, he was appointed as a Director, Executive Vice President, President and Chief Operating Officer of our company in 2001. In August 2002 he became the Chairman and Chief Executive Officer of our affiliate, China Oilfield Services Limited. In October 2003, Mr. Fu was appointed President of CNOOC. He was also appointed as the Chairman of the Board of Directors and Chief Executive Officer of our company, effective October 16, 2003. In November 2003, Mr. Fu resigned from his Chief Executive Officer position with China Oilfield Services Limited.

Han Luo received a doctorate degree from China Petroleum University. He has over 30 years' experience in the oil industry in the PRC. He was appointed as our executive director in December 2000. From 1993 to 1999, Mr. Luo served as Vice President of China Offshore Oil Eastern South China Sea Corporation and concurrently as Chairman of the CACT (CNOOC-AGIP-ChevronTexaco) operating group, and executive Vice President of China Offshore Oil East China Sea Corporation, a subsidiary of CNOOC. In 1999, he was the general manager of CNOOC China, Shanghai Branch. Mr. Luo is a Vice President of CNOOC, a position he has held since 2000. He joined CNOOC in 1982.

Longsheng Jiang received a B.S. degree from the Beijing Petroleum Institute in China. He has over 35 years of experience in the oil industry in the PRC. He was appointed as a Director of our company in December 2000 and has been the Vice President of CNOOC since 1998. From 1994 to 1998, he was the General Manager of China Offshore Oil Southern Drilling Company. From 1991 to 1994, Mr. Jiang served as the Deputy Chief Drilling Engineer and was later appointed as the Chief Drilling Engineer of China Offshore Oil Western South China Sea Corporation. He joined CNOOC in 1982. Mr. Jiang resigned from our board of director on June 1, 2005.

95

Shouwei Zhou received a doctorate degree from the Southwest China Petroleum Institute and is a senior engineer. He was appointed as a Director and Executive Vice President of our company in September 1999 and is responsible for the management and operation of CNOOC China Limited. Mr. Zhou was appointed President of our company in August 2002. Mr. Zhou was the Deputy General Manager and later promoted to become General Manager of China Offshore Oil Bohai Corporation and China Offshore Oil Tianjin Corporation, both subsidiaries of CNOOC. He also became the Chairman of CNOOC Engineering Company Limited, a subsidiary of CNOOC, in December 2003. He joined CNOOC in 1982.

Guangqi Wu received a B.S. degree in marine geology from the Ocean University of China. He also holds a master's degree in Economics and Management from the Central Communist Party School, the PRC and a master's degree in Management from the China Petroleum University. Mr. Wu joined CNOOC in 1982 and worked as a geologist in CNOOC Bohai Corporation, a subsidiary of CNOOC, and well logging manager for a joint venture under CNOOC. He was then appointed as manager of CNOOC Bohai Drilling Company and became the Deputy General Manager of CNOOC Oil Technical Services Company in 1994. Mr. Wu was appointed as director of the Administration Department of CNOOC in 1995 and as director of CNOOC Research Center in 1999. In 2001, Mr. Wu became the director of the Ideology Affairs Department of CNOOC. Mr. Wu was appointed President

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and Chief of Discipline and Inspecting Group of CNOOC in 2003, and he has been Vice President of CNOOC since 2004. Mr. Wu became our director on June 1, 2005. He has also been an independent non-executive director of China Yangtze Power Limited, a company listed on the Shanghai Stock Exchange since May 2003. Mr. Wu was appointed as our director with effect from June 1, 2005.

### Independent Non-executive Directors

Sung Hong Chiu received an LL.B. degree from the University of Sydney. He is admitted as a solicitor of the Supreme Court of New South Wales and the High Court of Australia. He has over 30 years' experience in legal practice and is a director of a listed company in Australia. Mr. Chiu is the founding member of the Board of Trustees of Australian Nursing Home Foundation and served as the General Secretary of the Australian Chinese Community Association of New South Wales. Mr. Chiu was appointed as an independent non-executive director of CNOOC in September 1999.

Erwin Schurtenberger is a senior advisor to the China Training Center for Senior Personnel Management Officials. He received a Ph.D. Degree in Economics and was trained in political science and philosophy at the University of Paris. He was the Ambassador of Switzerland to the People's Republic of China, the Democratic People's public of Korea and the Republic of Mongolia from 1988 to 1995. He joined the Swiss Foreign Services in 1969. Over the years, he held various diplomatic positions in Bangkok, Hong Kong, Beijing and Tokyo. He also served as the Ambassador of Switzerland to Iraq. He has been an independent business advisor to various European multinationals, American groups and humanitarian aid organizations. He was the President of the Swiss-Asia Foundation. He serves on the boards of directors of ROBERT BOSCH RBint, BUHLER GROUP Switzerland, FIRMENICH-China, TAIKANG Life Insurance and WINTERTHUR Insurances (Asia). Dr. Schurtenberger resigned from our board of directors on April 1, 2005.

Kenneth S. Courtis is the Managing Director of Goldman Sachs and Vice Chairman of Goldman Sachs Asia. He specializes in economics and strategy throughout the Asia-Pacific region as well as in Europe and North America. After graduating with honors from Glendon College in Toronto, Mr. Courtis received an M.A. in international economics from Sussex University, England, an M.B.A. in finance and strategy from the European Institute of Business Administration and a Ph.D. from the Institute of Economic and Political Studies in Paris. Prior to joining Goldman Sachs, he served as Chief Asia Economist and Strategist for Deutsche Bank.

Evert Henkes served as the CEO of Shell global chemical business from 1998 to 2003. Since joining Shell in 1973, he held various executive positions worldwide, including Managing Director of Shell Chemicals UK Ltd., Managing Director of Shell UK, President of Billiton Metals, Shell's Metals Coordinator, Shell's Chemical Coordinator, and Director of Strategy & Business Services of Shell

96

International Chemicals Ltd. He also served as directors in regional and global industrial bodies, including CEFIC and ICCA. He is also a director of Tate & Lyle Plc, BPB Plc, SembCorp Industries Ltd. and OutokumpuOy.

Aloysius Hau Yin Tse is a fellow of The Institute of Chartered Accountants in England and Wales, and the Hong Kong Institute of Certified Public Accountants, or HKICPA. Mr. Tse is a past president of the HKICPA. He joined KPMG in 1976 and became a partner in 1984 and retired in March 2003. Mr. Tse was a non-executive Chairman of KPMG's operations in the PRC and a

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member of the KPMG China advisory board from 1997 to 2000. Mr. Tse is currently an independent non-executive director of Wing Hang Bank, Limited and Linmark Group Limited, companies listed on the Hong Kong Stock Exchange. Mr. Tse is a graduate of the University of Hong Kong. Mr. Tse was appointed as our independent non-executive director with effect from June 8, 2005.

### Company Secretary

Yunshi Cao is our Company Secretary, General Counsel and a Senior Vice President. From 1992 to 1999, Mr. Cao was the Director of the Legal Department of CNOOC. He has been the General Counsel of CNOOC since 1999. Mr. Cao is a senior economist and licensed lawyer in the PRC. He has extensive experience in production sharing contracts. He received a B.S. degree from the Beijing Petroleum Institute and studied law at the Law School of Columbia University. He joined CNOOC in 1982.

### Senior Management

Hua Yang is the Chief Financial Officer (since January 1, 2005) and Senior Vice President of our company and the President of CNOOC International Limited. He is a senior engineer. He received his B.S. degree from China Petroleum Institute. He also received a MBA degree from the Sloan School of Management at Massachusetts Institute of Technology as a Sloan Fellow. He has over 22 years of experience in petroleum exploration and production. Mr. Yang joined CNOOC in 1982 and was the Deputy Director and Acting Director of the Overseas Development Department of CNOOC.

Mark Qiu was the Chief Financial Officer and Senior Vice President of our company and resigned from these positions on January 1, 2005 and March 25, respectively. He previously held several management positions at Atlantic Richfield Corporation ("ARCO") of United States. He was the Federal Government Relations Director of ARCO in Washington, D.C. Prior to that, he was a Vice President of ARCO China Ltd., ARCO's subsidiary in China. He was a consultant with the leadership succession planning consulting firm of RHR International. Mr. Qiu received a MBA degree from the Sloan School of Management at Massachusetts Institute of Technology as a Sloan Fellow. He also has a Master degree and a Ph.D. degree in Decision Sciences from the University of Texas at Arlington.

Wei Chen is a Senior Vice President of our company and Director of the CNOOC (China) Limited Research Center. He is a senior engineer and is responsible for our administration, foreign affairs, human resources and material procurement. He received his B.S. degree from China Petroleum University and holds an MBA degree from Tsinghua University. He has over 22 years of experience in petroleum exploration and production. Mr. Chen joined CNOOC in 1984 and previously served as the Deputy Manager for the Exploration and Development Department of CNOOC Research Center, the Deputy Manager of the Overseas Research Department, the Manager of the Information Department, the Deputy Director of CNOOC Research Center and the General Manager of the Human Resources Department of CNOOC, and the Senior Vice President and General Manager of our Administration Department.

Guohua Zhang is a Senior Vice President of our company and General Manager of our Exploration Department. Mr. Zhang is responsible for our exploration activities offshore China as well as reserve management. Mr. Zhang is a geologist. He graduated from Qingdao Oceanographic Institute with a B.S. degree. He studied in the Business Institute of University of Alberta in Canada in 2001. He joined CNOOC in 1982 and served as General Manager of the Exploration Department of China Offshore

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Oil Western South China Sea Corporation, Chief Geologist of CNOOC Research Center and Assistant to General Manager of CNOOC China Limited.

Jian Liu is the Senior Vice President and General Manager of the Department of Development and Production at CNOOC. He graduated from Huazhong University of Science and Technology with a B.S. degree and received his MBA degree from Tianjin University in 2000. He is a senior engineer and is responsible for the development and production of oil and gas. Mr. Liu joined CNOOC in 1982. He served as the manager of CNOOC Bohai Corporation, the Vice President of the Tianjin Branch and the President of the Zhanjiang Branch.

Ning Li is the Senior Vice President and General Manager of the Engineering and Project Department of our company. He is a senior engineer, responsible for the project management for oil and gas development. He received his B.S. degree from Petroleum University of China in 1983 and MBA degree from Tianjin University in 2000. Mr. Li joined CNOOC Bohai Corporation in 1983 and is responsible for the design and engineering of oil and gas fields in Bohai Bay, East China Sea and South China Sea. He has been a Vice President of Design & Engineering Corporation of CNOOC since 1994 and was appointed as the Deputy Manager of the Engineering Department of CNOOC in 1998.

### B. COMPENSATION OF DIRECTORS AND OFFICERS

Each of the directors entered into a service contract with us for an initial term of three years, subject to termination by either party by written notice given not less than three months prior to the expiration of the end of the initial term or any subsequent calendar month. Particulars of these contracts are in all material respects identical except as indicated below:

- o the annual salaries for Mr. Chengyu Fu and Mr. Shouwei Zhou during the initial three years are HK\$1,880,000 and HK\$1,680,000, respectively, subject to an annual increase as determined by the board of directors not exceeding 15% of their respective salaries for the previous year;
- o the chairman of our board of director and each other director (other than independent non-executive directors) shall be entitled to a maximum annual paid leave of 30 working days and 25 working days, respectively;
- o each of the directors (other than independent non-executive directors) is entitled to the use of an apartment as his residence and the use of a car provided free of charge by us together with certain other benefits and reimbursements;
- o the annual salary for each of the other directors (other than independent non-executive directors) during the initial three years is HK\$388,000, subject to an annual increase as determined by the board of directors not exceeding 15% of his then current salary; and
- o we may, at our sole discretion, pay an director (other than independent non-executive directors) a bonus in such amount as the board of directors may determine in respect of each completed financial year.

The salaries for Mr. Chengyu Fu and Mr. Shouwei Zhou were HK\$2,976,000 and HK\$2,256,00, respectively, for 2004. The salary for Mr. Chengyu Fu increased more than 15% from 2003 to 2004 as he took up the

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additional position as the chairman of our board of directors in October 2003. The aggregate amounts of salaries, housing allowances, other allowances and benefits in kind paid to our directors (other than independent non-executive directors) during the years ended December 31, 2002, 2003 and 2004 were approximately Rmb 9.5 million, Rmb 10.7 million and Rmb 7.8 million (US\$0.9 million), respectively, while the amounts paid to our executive officers for the same periods were approximately Rmb 8.0 million, Rmb 11.0 million and Rmb 12.6 million (US\$1.5 million), respectively. Under our pension plan for 2004, we set aside an aggregate amount of Rmb 74,300 (US\$8,977) and Rmb 172,000 (US\$20,782) for pension and similar benefits in kind for our directors (other than independent non-executive directors) and our executive officers respectively. Our directors (other than independent non-executive directors) and executive officers contributed an additional Rmb 59,700 (US\$7,213) and Rmb 159,400 (US\$19,259), respectively, to the pension plan for 2004. For further details regarding employee

98

compensation, see "Item 4--Information on the Company--Business Overview--Employees and Employee Benefits." For further details regarding share options granted to our directors, officers and employees, see "--Share Ownership" below.

### C. BOARD PRACTICE

#### Audit and Other Committees

We have established an audit committee, a remuneration committee and a nomination committee. Our audit committee meets at least twice a year and is responsible for reviewing the completeness, accuracy and fairness of the our accounts, evaluating our auditing scope and procedures, and evaluating internal control systems. The committee is also responsible for setting up internal monitoring systems so as to allow our board of directors to monitor our financial position, protect our assets, and prevent major errors resulting from financial reporting or loss. Our board of directors is responsible for these systems and appropriate delegations and guidance have been made. The audit committee regularly reports to the board of directors. As of June 8, 2005, our audit committee was composed of Mr. Sung Hong Chiu, Dr. Kenneth S. Curtis and Mr. Aloysius Hau Yin Tse.

The primary responsibilities of our remuneration committee are to review information in respect of our executives' remuneration, share option schemes, performance appraisal systems and retirement plans. As of June 8, 2005, our remuneration committee was composed of Mr. Sung Hong Chiu, Mr. Evert Henkes and Mr. Aloysius Hau Yin Tse.

The primary responsibilities of our nomination committee include nominating candidates for directors subject to our board of directors' approval, conducting routine examination of the structure, scale and composition of our board of directors, and review the leadership capabilities of our directors in order to ensure that we remain competitive. Because of the resignation of Dr. Erwin Schurtenberger, as of June 8, 2005, our nomination committee had two members, namely, Mr. Han Luo and Mr. Sung Hong Chiu.

For information on our audit committee finance expert and our code of ethics, see "Item 16A--Audit Committee Finance Expert," and "Item 16B--Code of Ethics."

International Advisory Board

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On October 29, 2001, we announced the establishment of an International Advisory Board with globally well-respected political figures and corporate leaders as members. The purpose of the International Advisory Board is to provide the management with strategic advice on world events and macro issues that may impact our development. Chengyu Fu, Chairman of our board of director, is the Chairman of the International Advisory Board.

99

Set forth below is information on the current members of our International Advisory Board.

Name	Biographical Information
Chengyu Fu	See "--A. Directors and Senior Management--Directors"
Erwin Schurtenberger	The Ambassador of Switzerland to the People's Republic of China, the Republic of Korea and the Republic of Mongolia from 1988 to 1995. He served in Foreign Services in 1969. Over the years, he held various diplomatic posts in Bangkok, Hong Kong, Beijing and Tokyo. He also served as the Ambassador to Iraq. He has been an independent business advisor to various European and American groups and humanitarian aid organizations. He was the President of the Swiss-Asia Foundation. He serves on the Boards of ROBERT BOSCH RBint, International Advisory Board, BUHLER GROUP Switzerland, FIRMENICH-Chinese Insurance, WINTERTHUR Insurances (Asia). Dr. Schurtenberger is also a member of the China Training Center for Senior Personnel Management Officials. He holds a Degree in Economics and was trained in political science and philosophy. Schurtenberger was a director on our board of directors from November 1, 2005.
Cornelius Herkstroter	Former Chairman of the Committee of Managing Directors of the Royal Dutch/Shell Group of Companies and President of Royal Dutch Petroleum Company. He spent his entire career in the mineral and resources industry, primarily with Royal Dutch. He holds various board and advisory positions with several global corporations and organizations.
Simon Murray	Former Executive Chairman of Asia Pacific for the Deutsche Bank Group. He is the founder of Davenham Investments, a project advisory company. He became a Director of Hutchison Whampoa in 1984. He is currently a Director of a number of companies that include Hutchison Whampoa, Cheung Kong Holdings, Tommy Hilf, United States and Vivendi Universal in France.
Edward S. Steinfeld	Assistant professor at the MIT Sloan School of Management. He received his undergraduate and doctoral training at Harvard University. As a consultant, he has conducted extensive firm-level research in China.
Peter Sutherland	Chairman and Managing Director of Goldman Sachs International and non-executive Chairman of BP plc. He served as Director General of the World Bank Organization from 1993 to 1995 and is a distinguished leader in world affairs. He holds various board and advisory positions with several global corporations and organizations.
Charles Freeman	Became Chairman of Projects International, Inc. in 1995, after an extensive career in the U.S. Government spanning three decades and numerous senior positions, including Ambassador to Saudi Arabia and Assistant Secretary of Defense for International Security.

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Affairs. He is currently president of the Middle East Policy Council, U.S. China Policy Foundation, vice-chair of the Atlantic Council, and Institute for Defense Analyses, among other positions. Ambassador Fre National Autonomous University of Mexico and received his A.B. from Yale as well as a J.D. from the Harvard Law School. He is the author of two books on statecraft and diplomacy: *The Diplomat's Dictionary* and *Arts*

100

### D. EMPLOYEES

See "Item 4--Information on the Company--Business Overview--Employees and Employee Benefits."

### E. SHARE OWNERSHIP

We have adopted share option schemes which provide for the grant of options to our senior management. Under these share option schemes, the remuneration committee of our board of directors will from time to time propose for the board's approval for the recipient of and the number of shares underlying each option. These schemes provide for issuance of options exercisable for shares granted under these schemes as described below, which in aggregate shall not exceed 10% of our issued share capital as of the date of approval by our shareholders of the scheme adopted in June 2002, excluding shares allotted and issued pursuant to the schemes from time to time. Discussions below in respect of the number of shares granted under our share option schemes and relevant per share data have been adjusted to take into account our 5-for-1 stock split on March 17, 2004.

On February 4, 2001 we adopted a pre-global offering share option scheme, or the Pre-Global Offering Share Option Scheme. Pursuant to the Pre-Global Offering Share Option Scheme:

- o options for an aggregate of 23,100,000 shares have been granted;
- o the subscription price per share is HK\$1.19; and
- o the period during which an option may be exercised is as follows:
  - (a) 50% of the shares underlying the option shall vest 18 months after the date of the grant; and
  - (b) 50% of the shares underlying the option shall vest 30 months after the date of the grant.

The exercise period for options granted under the Pre-Global Offering Share Option Scheme shall end not later than 10 years from March 12, 2001.

On February 4, 2001, we adopted a share option scheme, or the 2001 Share Option Scheme, for the purpose of recognizing the contribution that certain individuals had made to us and attracting and retaining the best available personnel.

Pursuant to the 2001 Share Option Scheme:

- o options for an aggregate of 44,100,000 shares have been granted;
- o the subscription price per share is HK\$1.232; and

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- o the period during which an option may be exercised is as follows:
  - (a) one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
  - (b) one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
  - (c) one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2001 Share Option Scheme shall end not later than 10 years from August 27, 2001. In view of the amendments to the relevant provisions of the Hong

101

Kong Stock Exchange listing rules regarding the requirements of the share option schemes of a Hong Kong listed company effective on September 1, 2001, no further options will be granted under the 2001 Share Option Scheme.

In June 2002, we adopted a new share option scheme, or the 2002 Share Option Scheme. Under the 2002 Share Option Scheme, our directors may, at their discretion, invite employees, including executive directors, of our company or any of our subsidiaries, to take up options to subscribe for shares. The maximum aggregate number of shares (including those that could be subscribed for under the Pre-Global Offering Share Option Scheme and the 2001 Share Option Scheme) which may be granted shall not exceed 10% of our total issued share capital. The maximum number of shares which may be granted under the 2002 Share Option Scheme to any individual in any 12 months period up to the next grant shall not exceed 1% of our total issued share capital from time to time.

According to the 2002 Share Option Scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. The subscription price of a share payable by a participant upon the exercise of an option will be determined by our directors at their discretion at the date of grant, except that such price may not be set below a minimum price which is the highest of:

- o the nominal value of a share;
- o the average closing price of the shares on the HKSE as stated in the HKSE's quotation sheets for the five trading days immediately preceding the date of grant of the option; and
- o the closing price of our shares on the HKSE as stated in the HKSE's quotation sheets on the date of grant of the option.

On February 24, 2003, our board of directors approved to grant options in respect of 42,050,000 shares to our senior management under the 2002 Share Option Scheme. The exercise price for the options is HK\$2.108 per share. On February 5, 2004, our board of directors approved a grant of options in respect of 50,700,000 shares to our senior management under the 2002 Share Option Scheme. The exercise price for the options is HK\$3.152 per share. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

- o one-third of the shares underlying the option shall vest on the



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first anniversary of the date of the grant;

- o one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
- o one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from the date on which the option is granted.

As of December 31, 2004, our directors and employees had the following personal interests in options to subscribe for shares granted under our share option schemes:

Name of Grantee	Number of shares involved in the options outstanding as of		Date of Grant	Closing price per share immediately before the date on which the options were granted	
	January 1, 2004	December 31, 2004 (1)		Before adjusted as per stock split	Adjusted as per stock split
				(HK\$)	(HK\$)
<b>Directors:</b>					
Chengyu Fu	350,000	1,750,000	March 12, 2001	--	
	350,000	1,750,000	August 27, 2001	7.30	
	230,000	1,150,000	February 24, 2003	10.45	
	500,000	2,500,000	February 5, 2004	15.65	
Han Luo	280,000	1,400,000	March 12, 2001	--	
	230,000	1,150,000	August 27, 2001	7.30	
	230,000	1,150,000	February 24, 2003	10.45	
	230,000	1,150,000	February 5, 2004	15.65	
Longsheng Jiang	280,000	1,400,000	March 12, 2001	--	
	230,000	1,150,000	August 27, 2001	7.30	
	230,000	1,150,000	February 24, 2003	10.45	
	230,000	1,150,000	February 4, 2004	15.65	
Shouwei Zhou	280,000	1,400,000	March 12, 2001	--	
	350,000	1,750,000	August 27, 2001	7.30	
	350,000	1,750,000	February 24, 2003	10.45	
	350,000	1,750,000	February 5, 2004	15.65	
Sunghong Chiu	230,000	1,150,000	February 5, 2004	15.65	

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Evert Henkes	230,000	1,150,000	February 5, 2004	15.65
Erwin Schurtenberger	230,000	1,150,000	February 5, 2004	15.65
Kenneth S Courtis	230,000	1,150,000	February 5, 2004	15.65
Employees:				
Other Employees	3,430,000	17,150,000	March 12, 2001	--
	7,660,000	38,300,000	August 27, 2001	7.30
	7,370,000	36,850,000	February 24, 2003	10.45
	7,910,000	39,550,000	February 5, 2004	15.65

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- (1) Adjustment has been made to take account of the subdivision of issued and unissued shares of HK\$0.10 each into five shares of HK\$0.02 each effective on March 17, 2004.

As of June 8, 2005, 2,300,100 options granted under our share option schemes have been exercised.

On April 1, 2005, Dr. Erwin Schurtenberger resigned from our board. He also surrendered the share options we granted to him upon resignation.

The weighted average fair value of the options granted under the Pre-Global Offering Share Option Scheme, the 2001 Share Option Scheme and the 2002 Share Option Scheme at the grant dates was HK\$0.84. This was estimated using the Black-Scholes option pricing model under the following assumptions: risk-free interest rates of 5.25%, expected volatility of 44%, an expected life of five years and an expected dividend yield of 2.0%. The assumptions on which the option pricing model is based represent the subjective estimations of our directors as to the circumstances existing at the time the options were granted.

For further details about our share option schemes, see notes 3 and 28 to our consolidated financial statements attached to this annual report.

As of June 8, 2005, none of our officers and directors owned 1% or more of our shares including the shares underlying the stock options granted as of that date.

103

### ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

#### A. MAJOR SHAREHOLDERS

The following table sets forth information regarding the ownership of our outstanding shares by major shareholders as of June 8, 2005.

Shareholder	Number of Shares Owned	Percentage
-----	-----	-----
CNOOC (1) .....	29,000,000 (2) (3)	70.64% (3)

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- (1) CNOOC owns our shares indirectly through its wholly owned subsidiaries, CNOOC (BVI) Limited and Overseas Oil & Gas Corporation Ltd.

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- (2) On March 17, 2004, our shareholders approved a five-for-one stock split of our shares. The stock split was effected by dividing our shares of HK\$0.10 each into the shares of HK\$0.02 each. Accordingly, the number of shares owned by CNOOC changed from 5,800,000,000 to 29,000,000,000 as a result of the stock split.
- (3) In 2004, we repurchased a total of 18,453,000 shares in the open market based on the general mandates approved by our shareholders on May 29, 2003 and June 14, 2004. For further details about our share buybacks, see "Item 16E--Purchases of Equity Securities by the Issuer and Affiliated Purchasers."

Our major shareholder listed above does not have different voting rights. Except as set forth in the above table, we are not aware of any holders of more than 5% of our shares. Nor are we aware of any significant changes in the percentage ownership of our major shareholder over the course of the past three years. To our knowledge, no arrangements are currently in place that could lead to a change of control of our company.

As of June 8, 2005, 7,463,545 American depository shares were outstanding in the United States, representing approximately 1.8% of our then outstanding shares. At such date, the number of registered American depository share holders in the United States was 17.

### B. RELATED PARTY TRANSACTIONS

#### Overview

We regularly enter into transactions with related parties, including CNOOC and its subsidiaries. Since CNOOC indirectly owns an aggregate of approximately 70.64% of our issued share capital, some of these transactions constitute connected transactions under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, or the Hong Kong Stock Exchange Listing Rules, and are regulated by the Hong Kong Stock Exchange.

Under the Hong Kong Stock Exchange Listing Rules, many of these connected transactions normally would require full disclosure and the prior approval of our independent shareholders. However, since the connected transactions are carried out in the ordinary and usual course of business and occur on a regular basis on normal commercial terms and on terms that are fair and reasonable as far as our shareholders are concerned, the Hong Kong Stock Exchange has granted us a waiver from strict compliance with requirements of the Hong Kong Stock Exchange Listing Rules. The waiver categorizes and limits the value of our various connected transactions.

We originally obtained a waiver from the Hong Kong Stock Exchange on April 3, 2001, shortly after our shares were listed on the Hong Kong Stock Exchange. This waiver expired on December 31, 2002, and we obtained a new waiver from the Hong Kong Stock Exchange on January 7, 2003. The new waiver covers the period from January 1, 2003 to December 31, 2005.

The Hong Kong Stock Exchange required us to obtain the approval of our independent shareholders for the proposed continuing connected transactions before it would grant us the new waiver. As an interested shareholder, CNOOC abstained from the shareholder vote on the proposed continuing connected transactions. We appointed an independent board committee to advise the independent shareholders on whether the terms of the proposed continuing connected transactions were in our interest and were fair and reasonable so far as the independent shareholders were concerned. An independent financial advisor, Cazenove Asia Limited, advised the independent board committee on the terms of the

continuing connected transactions. Our independent shareholders approved the proposed connected transactions at an extraordinary general meeting on December 23, 2002.

#### Categories of Connected Transactions

Our ongoing connected transactions in respect of which we were granted a waiver fall into the following eight categories:

- o Contracts with foreign petroleum companies;
- o Trademark license agreements;
- o Lease agreement in respect of the Nanshan terminal;
- o Provision of materials, utilities and ancillary services;
- o Technical services;
- o Research and development services;
- o Lease and property management services; and
- o Sales of crude oil, condensate oil and liquefied petroleum gas.

Contracts with foreign petroleum companies. In preparation for our initial public offering, CNOOC transferred to us all of its rights and obligations under all existing and any future production sharing contracts with various international oil and gas companies. As required by PRC law, CNOOC retained certain administrative functions and will remain a party to the production sharing contracts. PRC law requires a State-run entity, such as CNOOC, to negotiate and conclude an initial production sharing contract with a foreign partner offshore China. New production sharing contracts continue to be entered into between CNOOC and foreign partners, primarily through bidding organized by CNOOC and, to a lesser extent, through direct negotiation.

Trademark license agreements. CNOOC has licensed to us two "CNOOC" trademarks under non-exclusive license agreements that will expire on September 8, 2008. We paid a nominal amount of Rmb 1,000 for each of the trademarks. The registrations for the two trademarks will expire on December 6, 2008 and April 20, 2009, respectively. CNOOC has undertaken that so long as it is our controlling shareholder, it will renew the trademark registrations to enable us to continue using them without any additional consideration.

Lease agreement in respect of the Nanshan Terminal. Under an agreement dated September 9, 1999, CNOOC has granted us the right to use the Nanshan Terminal, Yacheng 13-1, free-of-charge for a period of 20 years. We use the property to process natural gas.

Provision of materials, utilities and ancillary services. Various subsidiaries of CNOOC provide us with the use of certain facilities and ancillary services and products, including:

- o materials for offshore oil and gas production (including cement, diesel oil, mud, fuels, barite and paint);
- o oil and gas production labor services;

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- o warehousing and storage;
- o road transportation services;
- o telecommunication and network services;

105

- o wharf services;
- o construction services, including the construction of roads, piers, buildings, plants and embankment;
- o major equipment maintenance and repair works;
- o medical, child care and social welfare services;
- o water, electricity and heat supply;
- o security and fire services; technical training; accommodation;
- o repair and maintenance of buildings; and
- o catering services.

Under agreements between these subsidiaries of CNOOC and us, the facilities and ancillary products and services are to be provided at:

- (i) government-prescribed prices; or
- (ii) where there is no government-prescribed price, market prices, including the local or national market prices; or
- (iii) when neither (i) nor (ii) is applicable, the cost to CNOOC's associates of providing the relevant materials, utilities and ancillary services, including the cost of sourcing or purchasing from third parties, plus a margin of not more than 5%, before any applicable taxes.

The prices, volumes and other terms of the agreements are reviewed by the parties annually. If any of the terms are amended, the parties must enter into a supplemental agreement no later than 60 days prior to the end of the financial year preceding the financial year in which the amendment takes effect. If the parties fail to reach an agreement by then, the existing terms of the supply agreement will continue to apply until the parties agree on the terms of the supplemental agreement. We have undertaken to the Hong Kong Stock Exchange that we will comply with the provisions of the Hong Kong Stock Exchange Listing Rules with respect to any supplemental agreements.

For the three years ended December 31, 2004, the amounts we paid to subsidiaries of CNOOC for these services were approximately Rmb 789 million, Rmb 1,018 million and Rmb 1,296 million, respectively, representing 3.0%, 2.5% and 2.3%, respectively, of our total revenues in that year.

Technical services. Various subsidiaries of CNOOC, including China Oilfield Services Limited and CNOOC Offshore Oil Engineering Company Limited, provide us with technical and labor services for our offshore oil and gas production activities, including:

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- o offshore drilling;
- o ship tugging, oil tanker transportation and security services;
- o well surveys, well logging, well cementing and other related technical services;
- o collection of geophysical data, ocean geological prospecting, and data processing;
- o platform fabrication service and maintenance; and
- o design, construction, installation and test of offshore and onshore production facilities.

106

For the three years ended December 31, 2004, the amounts we paid to subsidiaries of CNOOC for these services totaled approximately Rmb 3,280 million, Rmb 3,828 million and Rmb 6,362 million, respectively, representing 12.4%, 9.3% and 11.5%, respectively, of our total revenue in that year. We generally conduct an open bidding process to select these services providers and the charges for these services are based on arm's-length negotiations between the parties and reflect considerations such as volume of sales, length of contracts, overall customer relationship and other market factors.

Research and development services. Various subsidiaries and affiliates of CNOOC, including CNOOC Research Center, have been providing us with research and development services, including:

- o geophysical exploration services;
- o seismic data processing;
- o comprehensive exploration research services; and
- o information technology services.

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 three years ended December 31, 2002, 2003 and 2004, we paid approximately Rmb 110 million, Rmb 56 million and Rmb 8 million, respectively, to CNOOC Research Center for its provision of general research and development services. We occasionally also hired research institutes, including CNOOC Research Center, through an open bidding process for specific research and development projects.

Lease and property management services. We have entered into lease and property management agreements with CNOOC and its subsidiaries for premises located in Beijing, Tianjin, Zhanjiang, Shanghai and Shenzhen in the PRC and in Singapore. Most of the premises are necessary for our operations, and the agreements are based on normal commercial terms. For the three years ended December 31, 2004, the aggregate rentals and management fees payable by us to CNOOC and its subsidiaries were approximately Rmb 54 million, Rmb 57 million and Rmb 77 million, respectively.

Sales of crude oil, condensate oil and liquefied petroleum gas. We

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sell crude oil, condensate oil and liquefied petroleum gas to affiliates of CNOOC that engage in the downstream petroleum business. The prices for these products are based on prices in the international market. For the three years ended December 31, 2004, subsidiaries of CNOOC paid us approximately Rmb 4,362 million, Rmb 8,324 million and Rmb 13,946 million, respectively, representing approximately 16.5%, 20.3% and 25.3% of our total revenues for the respective periods.

### Waiver Conditions

The waiver granted by the Hong Kong Stock Exchange to us in January 2003 contains the following typical conditions:

- i. in relation to the ongoing connected transactions referred to in the paragraphs headed "Contracts with foreign petroleum companies," "Trademark license agreements" and "Lease agreement in respect of the Nanshan Terminal" the transactions, and the respective agreements (if any) governing such transactions, must be on terms that are fair and reasonable so far as our shareholders are concerned and in relation to the ongoing connected transactions referred to in the paragraphs headed "Provision of materials, utilities and ancillary services," "Technical services," "Research and development services," "Lease and property management services" and "Sales of crude oil, condensate oil and liquefied petroleum gas" the transactions, and the respective agreements (if any) governing such transactions must be:
  - a. entered into by us in our ordinary and usual course of business;
- 107
- b. either on normal commercial terms or, where there is no available comparison, on terms no less favorable than those available to or from independent third parties; and
- c. on terms that are fair and reasonable so far as our shareholders are concerned;
- ii. brief details of the continuing connected transactions in each year as required by Rule 14.25(1)(A) to (D) of the Hong Kong Stock Exchange Listing Rules then in force before March 31, 2004 (i.e., the date or period of the transaction, the parties thereto and a description of their connected relationship, a brief description of the transaction and the purpose of the transaction, the total consideration and the terms, and the nature and the extent of the interest of the connected person in the transaction), must be disclosed in our annual report and accounts for the relevant year;
- iii. our independent non-executive directors must review annually the transactions and confirm, in our annual report and accounts for the year in question, that such transactions have been conducted in the manner stated in (i) above and, where applicable, within the annual limit stated in (v) below;
- iv. our auditors must carry out review procedures annually in relation to the connected transactions and must confirm in

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writing whether the transactions:

- a. received the approval of our board of directors;
- b. have been entered into in accordance with the pricing policies as stated in our financial statements; and
- c. have been entered into in accordance with the terms of the agreement governing the transactions or, where there is no agreement, on terms that are not less favorable than terms available to or from independent third parties;

For the purpose of the above review by our auditors, CNOOC has undertaken to us that it will provide the auditors with access to its relevant accounting records;

- v. the aggregate annual volume of transactions shall not exceed the proposed annual limits set out in the following table:

Transaction	Annual Limit	Basis for Determining the Annual Limit
Materials, utilities and ancillary services supply agreements	10% of our audited consolidated total revenues in the preceding financial year	Under our original waiver, the annual this category of transactions was 3.91 total revenues. The new annual limit past transaction amounts and future pr We believe that new projects warrant t additional flexibility.
Technical services	In respect of the three financial years ending December 31, 2005, Rmb 5,853 million, Rmb 7,338 million and Rmb 4,880 million, respectively	Under our original waiver, the maximum this category of transactions was Rmb for the year ended December 31, 2002. annual limits take into consideration expansion of existing oilfields and th development of two new oilfields in th
Research and development services for particular	In respect of the three financial years ending December 31, 2005, Rmb 141 million, Rmb	Under our original waiver, the annual this category of transactions was Rmb The new annual limits are based on the prior years and a projection of
projects	148 million and Rmb 153 million, respectively	our future needs for such services.
Sales of crude oil, condensate oil and liquefied petroleum gas	In respect of the three financial years ending December 31, 2005, 42%, 56% and 82%, respectively, of our audited consolidated total revenues in the preceding	Under our original waiver, the maximum this category of transactions was Rmb million (representing 18% of our audit consolidated revenues for the year end 31, 2002). The new annual limits are amount of past sales and expected incr this category because of the ongoing d



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	financial year	
		of existing oilfields and the development of new oilfields in the Bohai Bay. The items also reflect our anticipated need to upgrade refining processes for heavy crude oil and other developments and the possibility that an increasing proportion of our oil and gas will be processed by CNOOC because of generally lower transportation costs.
<hr style="border-top: 1px dashed black;"/>		
General research and development services agreement	Rmb 110 million	The new annual limit for this category of transactions is the same as the limit in the original waiver granted by the Hong Kong Stock Exchange and takes into consideration our anticipated need for these services.
<hr style="border-top: 1px dashed black;"/>		
Lease and management services	Rmb 78 million	Under our original waiver, the maximum limit for this category of transactions was Rmb 100 million. The new waiver amount is based on possible expansion and the unavailability of alternative providers.
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- vi. we undertook that if any of the terms of the agreements or arrangements referred to above are altered or if we enter into any new agreements with any connected persons (within the meaning of the Hong Kong Stock Exchange Listing Rules) in the future or if the limits stated in (v) above are exceeded, we will comply with the standard disclosure and shareholder approval provisions in the Hong Kong Stock Exchange Listing Rules unless we apply for and obtain a separate waiver from the Hong Kong Stock Exchange.

In addition to the connected transactions disclosed above, from time to time we place cash deposits with CNOOC Finance Corporation Limited, or CNOOC Finance. CNOOC Finance is a majority-owned subsidiary of CNOOC and operates as a non-bank finance company under the supervision of the People's Bank of China, or PBOC, the PRC central bank. We acquired a 31.8% interest in CNOOC Finance in September 2003. The interest rates offered by CNOOC Finance were the same as the rates promulgated by the PBOC which were applicable to account deposits with PRC banks or finance companies and ranged from 0.72% to 2.07% per annum. As of December 31, 2004, we had cash and cash equivalents and time deposits aggregating Rmb 3,298 million placed with CNOOC Finance. On April 8, 2004, we entered into a framework agreement with CNOOC Finance. Pursuant to the framework agreement, we and our subsidiaries will from time to time utilize financial services from CNOOC Finance, including placing of cash deposits and other settlement services. The maximum outstanding balance for deposits, including interest receipts in respect of these deposits, placed with CNOOC Finance during the term of the framework agreement will not exceed Rmb 6,800 million. Such arrangement with CNOOC Finance was approved in the extraordinary general meeting of our shareholders on April 28, 2004.

109

During 2004, we also imported oil into the PRC for trading, using CNOOC's import license. As of December 31, 2004, total sales to our customers through such arrangements amounted to approximately Rmb 446,923,000 (2003: Rmb 1,470,832,000). The commission paid by the third party customers to CNOOC for the year amounted to approximately Rmb 2,682,000 (2003: Rmb 8,825,000).

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For further information regarding related party transactions, see note 26 to our consolidated financial statements attached to this annual report.

### C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

See pages beginning on page F-1 following Item 19.

### Legal Proceedings

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

### Dividend Distribution Policy

We intend to declare and pay dividends in the future. The payment and the amount of any dividends will depend on our results of operations, cash flow, financial condition, the payment by our subsidiaries of cash dividends to us, future prospects and other factors which our directors may consider relevant. In addition, as our controlling shareholder, CNOOC will be able to influence our dividend policy. Holders of our shares will be entitled to receive such dividends declared by our board of directors pro rata according to the amounts paid up or credited as paid up on the shares. Subject to the factors described above, we currently intend to pursue a dividend policy consistent with other international oil and gas exploration and production companies. Based on current share prices and dividends of international oil and gas exploration and production companies, we currently intend to target an initial dividend yield of approximately 1% to 3%.

Dividends may be paid only out of our distributable profits as permitted under Hong Kong law, which does not restrict the payment of dividends to nonresident holders of our securities. To the extent profits are distributed as dividends, such portion of profits will not be available to be reinvested in our operations.

Holders of our ADSs will be entitled to receive dividends, subject to the terms of the deposit agreement, to the same extent as holders of our shares, less the fees and expenses payable under the deposit agreement. Cash dividends will be paid to the depository in Hong Kong dollars and, will be converted by the depository into U.S. dollars and paid to holders of ADSs. Stock dividends, if any, will be distributed to the depository and will be distributed by the depository, in the form of additional ADSs, to holders of the ADSs.

Following the reorganization of CNOOC and our establishment as a separate legal 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 2001, 2002 and 2003, we declared and paid dividends totaling Rmb 871.1 million, Rmb 2,265.1 million and Rmb 5,403.7 million, respectively. In 2004, we declared dividends totaling Rmb 6,101.4 million (US\$737.2 million) and paid dividends totaling Rmb 6,091.4 million (US\$736.0 million). The difference between the amount of dividends declared and paid in 2004 was because that we repurchased and canceled some of our shares in 2004. Out of the total dividends declared and paid in 2004, Rmb 2,617.5 million (US\$316.3

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million) was attributable to a special interim dividend to replace the 2003 final dividend and final special dividend proposed by our board of directors

110

in 2003. On May 25, 2005, we declared a final dividend of Rmb 3,493.4 million (US\$422.1 million) for fiscal year 2004, which was paid in full on June 7, 2005. The amount of dividends we paid historically is not indicative of the dividends that we will pay in the future.

Substantially all our dividend payments result from dividends paid to us by CNOOC China Limited. CNOOC China Limited must follow the laws and regulations of the PRC and its articles of association in determining its dividends. As a wholly foreign owned enterprise in China, CNOOC China has to provide for a reserve fund and staff and workers' bonus and welfare fund, each of which is appropriated from net profit after taxation but before dividend distribution according to the prevailing accounting rules and regulations in the PRC. CNOOC China is required to allocate at least 10% of its net profit to the reserve fund until the balance of this fund has reached 50% of its registered capital. Appropriations to the staff and workers' bonus and welfare fund, which are determined at the discretion of CNOOC China's directors, are charged to expense as incurred in the consolidated financial statements, which were prepared under Hong Kong GAAP. None of CNOOC China's contributions to these statutory funds may be used for dividend purposes.

For the years ended December 31, 2002, 2003 and 2004, CNOOC China Limited made the following appropriations to the statutory reserves:

	For the year ended December 31, 2002		For the year ended December 31, 2003		F
	Percentage of Net Profits	Rmb (in millions)	Percentage of Net Profits	Rmb (in millions)	D
Reserve fund.....	10%	697.1	10%	818.1	
Staff and workers' bonus and welfare fund.....	--	--	--	--	

### B. SIGNIFICANT CHANGES

#### First Quarter 2005 Financial and Operating Results

During the first quarter of 2005, our unaudited revenues from the sale of oil and gas were Rmb 11.4 billion. Our daily average crude oil production was 351,579 barrels per day during this period, compared to 306,980 barrels per day in 2004, while our daily average natural gas production was 348 million cubic feet per day, compared to 323 million cubic feet per day in 2004. The average net realized price of our crude oil was US\$41.73 per barrel during the first quarter of 2005, compared to US\$29.79 per barrel in 2004, while the average net realized price of our natural gas was US\$2.92 per thousand cubic feet, compared to US\$2.80 per thousand cubic feet in 2004.

Changes of Directors and Management

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Dr. Mark Qiu resigned as our Chief Financial Officer and Senior Vice President with effect from January 1, 2005 and March 25, 2005, respectively. Mr. Hua Yang succeeded Dr. Mark Qiu as our Chief Financial Officer on January 1, 2005.

Dr. Erwin Schurtenberger resigned as our independent non-executive director on April 1, 2005 due to health-related reasons. He maintains his position as a member of our International Advisory Board after his resignation from our board of directors. Mr. Aloysius Hau Yin Tse succeeded Dr. Erwin Schurtenberger as an independent non-executive director of our company with effect from June 8, 2005.

Mr. Longsheng Jiang resigned from our board of director on June 1, 2005. Mr. Guangqi Wu succeeded Mr. Longsheng Jiang as a director of our company on the same date.

111

### ITEM 9. THE OFFER AND LISTING

Not applicable, except for Item 9.A.4 and Item 9.C.

We listed our shares on the Hong Kong Stock Exchange and our ADSs on the New York Stock Exchange in February 2001. Our shares are listed on the Hong Kong Stock Exchange under the stock code "883" and our ADSs are listed on the New York Stock Exchange under the symbol "CEO." 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. The ratio of our American depositary shares 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. The following table sets forth, for the periods indicated, the high and low closing prices per share, as reported on the Hong Kong Stock Exchange and adjusted retroactively to reflect the stock split, and per ADS, as reported on the New York Stock Exchange.

Period	Hong Kong Stock Exchange		New York Stock Exchange	
	High (HK\$ per share)	Low	High	Low
2002.....	2.33	1.48	29.44	19.01
2003.....	3.54	1.96	42.78	23.83
2004.....	4.53	2.75	58.73	35.00
2003 Financial Quarters				
1st Quarter.....	2.19	1.96	26.72	23.83
2nd Quarter.....	2.32	1.98	29.00	24.11
3rd Quarter.....	2.92	2.28	37.45	30.18
4th Quarter.....	3.54	2.66	42.78	34.52
2004 Financial Quarters				
1st Quarter.....	3.4	2.95	43.65	38.80
2nd Quarter.....	3.45	2.65	44.23	35.00
3rd Quarter.....	4.07	3.20	52.60	41.75

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4th Quarter.....	4.53	3.97	58.73	51.21
2005 Financial Quarter				
1st Quarter.....	4.57	3.85	57.91	49.50
Last Six Months				
December 2004.....	4.40	4.05	56.39	52.28
January 2005.....	4.18	3.85	53.54	49.50
February 2005.....	4.53	3.88	57.40	49.83
March 2005.....	4.57	4.20	57.91	53.82
April 2005.....	4.40	3.95	55.75	51.20
May 2005.....	4.40	4.08	56.59	52.62

112

### ITEM 10. ADDITIONAL INFORMATION

#### A. SHARE CAPITAL

Not applicable.

#### B. MEMORANDUM AND ARTICLES OF ASSOCIATION

We were incorporated with limited liability on August 20, 1999 in Hong Kong under the Companies Ordinance of Hong Kong. Our company registration number in Hong Kong is 685974. Under section three of our memorandum of association, we have the capacity and the rights, powers and privileges of a natural person and in addition and without limit, we may do anything which we are permitted to do by any enactment or rule of law. The following are summaries of provisions of our memorandum of association and articles of association and the Companies Ordinance (Chapter 32 of the Laws of Hong Kong). For further details, you should read our memorandum of association which was filed as an exhibit to our registration statement on Form F-1 (Registration No. 333-10862) and our articles of association, as amended, which is filed as an exhibit to this annual report.

##### Issue of Shares

Under the Companies Ordinance of Hong Kong, our directors may, without prior approval of the shareholders, offer to allot new shares in our company to existing shareholders pro rata. The directors may not allot new shares of our company in any other manner without the prior approval of the shareholders in a general meeting. Any approval given in a general meeting shall continue in force until the earliest to occur of the following events:

- o the conclusion of the following annual general meeting,
- o the expiration of the period within which the next annual general meeting is required by law to be held, or
- o when revoked or varied by an ordinary resolution of the shareholders, in a general meeting of our company.

If such approval is given, the unissued shares of our company shall be at the disposal of the board of directors. The directors may offer, allot, grant options over or otherwise dispose of the unissued shares to persons at such times and for such consideration and upon such terms and conditions as the directors may determine.

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In accordance with the listing rules of the Hong Kong Stock Exchange, any such approval of the shareholders must be limited to shares with an aggregate nominal value not exceeding 20% of the aggregate value of our share capital in issue plus the aggregate nominal amount of share capital repurchased by us since the granting of such approval.

### Dividends

Subject to the Companies Ordinance of Hong Kong, the shareholders in a general meeting may declare dividends to be paid to shareholders. However, under our articles of association, dividends cannot be declared in excess of the amount recommended by the board of directors.

In addition to dividends declared in a general meeting, the board of directors may declare and pay to the shareholders interim dividends as appear to the board of directors to be justified by our financial position. The board of directors may also pay any fixed dividend on any shares of our company semi-annually or at other suitable intervals, whenever our financial position, in their opinion, justifies such payment.

113

### Winding Up

If we are wound up, the liquidator may, with the sanction of a special resolution, divide among our shareholders in specie or in kind the whole or any part of our assets or vest any part of our assets in trustees upon such trusts for the benefit of our shareholders or any of them as the resolution shall provide.

### Voting Rights

Under the Companies Ordinance of Hong Kong, any action to be taken by the shareholders in a general meeting requires the affirmative vote of either an ordinary or a special resolution passed at such meeting.

- o An ordinary resolution is a resolution passed by the majority of shareholders that are entitled to, and do, vote in person or by proxy at a general meeting.
- o A special resolution is a resolution passed by not less than 75% of shareholders that are entitled to, and do, vote in person or by proxy at a general meeting.

Generally, resolutions of shareholders are passed by ordinary resolution. However, the Companies Ordinance of Hong Kong provides that some matters may only be passed as special resolutions. These matters include:

- o alteration of the object clause,
- o alteration of the articles,
- o change of a company's name,
- o reduction of share capital, and
- o voluntary winding up.

Voting at any meeting of shareholders is by a show of hands unless a

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poll is demanded. If voting is by a show of hands, every shareholder who is present at the meeting in person or by proxy has one vote. On a poll, every shareholder who is present in person or by proxy has one vote for every share held or represented by him. A poll may be demanded in some circumstances by:

- o the chairman of the meeting,
- o at least three shareholders present in person or by proxy and entitled to vote at the meeting,
- o shareholders present in person or by proxy who represent in the aggregate not less than 10% of the total voting rights of all shareholders having the right to attend and vote at the meeting, or
- o shareholders present in person or by proxy and holding shares conferring a right to amend and vote at the meeting on which there have been paid up sums in the aggregate equal to not less than 10% of the total sum paid up on all shares conferring that right.

Any action to be taken by the shareholders requires the affirmative vote of the requisite majority of the shares at a meeting of shareholders. There are no cumulative voting rights. Accordingly, the holders of a majority of the shares voting for the election of directors can elect all the directors if they choose to do so.

114

### General Meetings

We are required to hold an annual general meeting of shareholders each year within 15 months from the date of our last annual general meeting. We may also hold extraordinary general meetings of shareholders from time to time. Our board of directors may convene an extraordinary general meeting at will, and shall on requisition in accordance with the Companies Ordinance of Hong Kong, proceed to convene an extraordinary general meeting. Our annual general meeting and any extraordinary general meeting called for the purpose of passing a special resolution requires at least 21 days' prior notice, and any other general meeting requires at least 14 days' prior notice. The notice must specify the place, day and time of the meeting and, in the case of special business, the general nature of that business. The quorum for a general meeting is two shareholders present in person or by proxy. If within thirty minutes from the time appointed for the meeting a quorum is not present, the meeting, if convened upon requisition in accordance with the Companies Ordinance of Hong Kong, must be dissolved; but in any other case it must stand adjourned to the same day in the next week at the same time and place, or to such other day, time and place as the Chairman of the meeting may determine. If at such adjourned meeting a quorum is not present within thirty minutes from the time appointed for the meeting, the member or members present in person or by proxy shall be a quorum and may transact the business for which the meeting is called.

### Modification of Rights

Subject to the Companies Ordinance of Hong Kong, any of the rights attaching to any class of shares, unless otherwise provided for by the terms of issue of the shares of that class, may be varied or abrogated with the written consent of the holders of not less than 75% of the issued shares of

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that class or with the sanction of a special resolution passed at a separate general meeting of the holders of shares of that class.

### Borrowing Powers

Our board of directors may exercise all the powers of our company to borrow money and to mortgage or charge all or any part of our undertaking, property and assets, whether present or future, and uncalled capital. Our board of directors may issue debentures, debenture stock, bonds or other securities of our company, whether outright or as collateral security for any debt, liability or obligation of our company or of any third party. These borrowing powers are subject to variation by a special resolution of our company.

### Interested Transactions

Subject to the exceptions described below, none of our directors may vote on any contract, arrangement or proposal in which the director or any of his or her associates is materially interested. For this purpose, existence of material interest is presumed if a company, in which the director and/or his or her associates beneficially own 5% or more of any class of its shares or voting rights, is materially interested in the transaction. Our directors may, however, vote on the following matters:

- o any contract or arrangement to give security or indemnity to the director or his or her associates for money lent or obligations undertaken by such director or his or her associates at the request of or for the benefit of our company or subsidiaries;
  - o any contract or arrangement to give security or indemnity to a third party for our debts or debts of our subsidiaries for which such director or his or her associates assumed responsibility by giving guarantee or security;
  - o any contract or arrangement concerning offering of securities by us (or any company which we may promote or be interested in purchasing) for which the director or his or her associates participate in the underwriting or sub-underwriting;
- 115
- o any contract or arrangement in which the director or his or her associates are interested only by virtue of their interest in our securities;
  - o any contract or arrangement concerning any other company in which the director or his or her associates are interested as an officer or executive or a shareholder in which the director or his or her associates are beneficially interested in shares of that company other than a company in which they in aggregate beneficially own more than 5% of the issued shares of any class or voting rights;
  - o any proposal or arrangement concerning employee benefits that do not provide privileges to our directors or their associates, including employee share schemes and retirement, death or disability benefits schemes; and
  - o any proposal or arrangement concerning the adoption, modification



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or operation of any employees' share scheme involving the issue or grant of options over shares or other securities by us to, or for the benefit of, our employees or employees of our subsidiaries under which the director or his or her associates may benefit.

### C. MATERIAL CONTRACTS

Incorporated by reference to our registration statement on Form F-1 (Registration No. 333-10862), to which most of our current material contracts were filed as exhibits. For additional information on our material contracts, see "Item 7--Major Shareholders and Related Party Transactions--Related Party Transactions" and "Item 19--Exhibits."

### D. EXCHANGE CONTROLS

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

- o debt service on foreign currency denominated debt;
- o overseas acquisitions of oil and gas properties;
- o purchases of imported equipment; and
- o payment of dividends declared in respect of shares held by international investors.

CNOOC China Limited 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.

Since 1994, the conversion of Renminbi into Hong Kong and United States dollars has been based on rates set by the People's Bank of China, which are set daily based on the previous day's PRC interbank foreign exchange market rate and current exchange rates on the world financial markets. The PRC government has stated publicly that it intends to make Renminbi freely convertible in the future. However, we cannot predict when the PRC government will allow free conversion of Renminbi into foreign currencies. Renminbi devaluation and fluctuations in exchange rates may adversely affect the value, translated or converted into U.S. dollars or Hong Kong dollars, of our net assets, earnings and any declared dividends. Renminbi devaluation and exchange rate fluctuations may adversely affect our results of operations and financial condition and may result in foreign exchange losses because of our substantial U.S. dollar and Japanese yen-denominated debts, expenses and other requirements. In addition, we may not be able to increase the Renminbi prices of our domestic sales to offset fully any

depreciation of the Renminbi due to political, competitive or social pressures. We do not hedge exchange rate fluctuations between the Renminbi and

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foreign currencies and currently have no plans to do so. 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."

### E. TAXATION

The taxation of income and capital gains of holders of our shares or ADSs is subject to the laws and practices of Hong Kong and of jurisdictions in which holders of our shares or ADSs are resident or otherwise subject to tax. The following is a summary of taxation provisions that are anticipated to be material based on current law and practice, is subject to change and does not constitute legal or tax advice. The discussion does not deal with all possible tax consequences relating to an investment in our shares or ADSs. In particular, the discussion does not address the tax consequences under state, local and other laws, such as non-Hong Kong and non-U.S. federal laws. Accordingly, we urge you to consult your tax adviser regarding the tax consequences of an investment in our shares and ADSs. The discussion is based upon laws and relevant interpretations in effect as of the date of this annual report, all of which are subject to changes. There is no reciprocal tax treaty in effect between Hong Kong and the United States.

#### Hong Kong

##### Tax on Dividends

Under the current practices of the Hong Kong Inland Revenue Department, no tax is payable in Hong Kong in connection with dividends paid by us.

##### Profits Tax

No tax is imposed in Hong Kong in respect of capital gains from the sale of property, such as the shares and ADSs. Trading gains from the sale of property by persons carrying on a trade, profession or business in Hong Kong where such gains are derived from or arise in Hong Kong from such trade, profession or business will be chargeable to Hong Kong profits tax which is currently imposed at the rate of 17.5% on corporations and at a maximum rate of 16% on individuals. Gains from sales of the shares effected on the Hong Kong Stock Exchange will be considered to be derived from or arise in Hong Kong. Liability for Hong Kong profits tax would thus arise in respect of trading gains from sales of shares or ADSs realized by persons carrying on a business of trading or dealing in securities in Hong Kong.

##### Stamp Duty

Hong Kong stamp duty, currently charged at the rate of HK\$1.00 per HK\$1,000 or part thereof on the higher of the consideration for or the value of the shares, will be payable by the purchaser on every purchase and by the seller on every sale of shares. For example, a total of HK\$2.00 per HK\$1,000 or part thereof is currently payable on a typical sale and purchase transaction involving shares. In addition, a fixed duty of HK\$5 is currently payable on any instrument of transfer of shares. The withdrawal of shares upon the surrender of ADRs, and the issuance of ADRs upon the deposit of shares, will also attract stamp duty at the rate described above for sale and purchase transactions unless the withdrawal or deposit does not result in a change in the beneficial ownership of the shares under Hong Kong law. The issuance of the ADRs upon the deposit of shares issued directly to the depository or for the account of the depository does not attract stamp duty. No Hong Kong stamp duty is payable upon the transfer of ADSs outside Hong Kong.

##### Estate Duty

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The shares are Hong Kong property under Hong Kong law, and accordingly such shares may be subject to estate duty on the death of the beneficial owner of such shares, regardless of the place of the owner's residence, citizenship or domicile. We cannot assure you that the Hong Kong Inland Revenue Department will not treat the ADRs as Hong Kong property that may be subject to estate duty on the

117

death of the beneficial owner of the ADR even if the ADRs are located outside Hong Kong at the date of such death. Hong Kong estate duty is imposed on a progressive scale from 5% to 15%. The rate of and the threshold for estate duty has, in the past, been adjusted on a fairly regular basis. No estate duty is payable when the aggregate value of the dutiable estate does not exceed HK\$7.5 million, and the maximum rate of duty of 15% applies when the aggregate value of the dutiable estate exceeds HK\$10.5 million. The Hong Kong Government is considering abolishing estate duty in Hong Kong.

### United States

#### Federal Income Tax Considerations

The following is a summary of United States federal income tax considerations that are anticipated to be material for U.S. Holders, as defined below. This summary is based upon existing United States federal income tax law, which is subject to change, possibly with retroactive effect. This summary does not discuss all aspects of United States federal income taxation which may be important to particular investors in light of their individual investment circumstances, such as investors subject to special tax rules including: partnerships, financial institutions, insurance companies, broker-dealers, tax-exempt organizations, and, except as described below, non-U.S. Holders, or to persons that will hold our shares or ADSs as part of a straddle, hedge, conversion, or constructive sale transaction for United States federal income tax purposes or that have a functional currency other than the United States dollar, all of whom may be subject to tax rules that differ significantly from those summarized below. In addition, this summary does not discuss any foreign, state, or local tax considerations. This summary assumes that investors will hold our shares or ADSs as "capital assets" (generally, property held for investment) under the United States Internal Revenue Code. Each prospective investor is urged to consult its tax advisor regarding the United States federal, state, local, and foreign income and other tax considerations of the purchase, ownership, and disposition of our shares or ADSs.

For purposes of this summary, an U.S. Holder is a beneficial owner of shares or ADSs that is for United States federal income tax purposes:

- o an individual who is a citizen or resident of the United States;
- o a corporation, partnership or other entity created in or organized under the laws of the United States or any State or political subdivision thereof;
- o an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source;
- o a trust the administration of which is subject to the primary

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supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust; or

- o a trust that was in existence on August 20, 1996, was treated as a United States person, for United States federal income tax purposes, on the previous day, and elected to continue to be so treated.

A beneficial owner of our shares or ADSs that is not a U.S. Holder is referred to herein as a "Non-U.S. Holder."

A foreign corporation will be treated as a "passive foreign investment company" or "PFIC", for United States federal income tax purposes, if 75% or more of its gross income consists of certain types of "passive" income or 50% or more of its assets produce or are held for the production of passive income. Based on our current and projected income, assets, and activities, we presently believe that we are not a PFIC and do not anticipate becoming a PFIC. This is, however, a factual determination made on an annual basis. Because the classification of certain of our interests for United States federal income tax purposes is uncertain and the PFIC rules are subject to administrative interpretation, however, no assurance can be given that we are not or will not be treated as a PFIC. The discussion below under "U.S. Holders-Dividends" and "U.S. Holders-Sale or Other Disposition of Shares or ADSs," assumes that we will not be subject to treatment as a PFIC for United States federal income tax purposes.

118

### U.S. Holders

For United States federal income tax purposes, a U.S. Holder of an ADS will be treated as the owner of the proportionate interest of the shares held by the depository that is represented by an ADS and evidenced by such ADS. Accordingly, no gain or loss will be recognized upon the exchange of an ADS for the holders' proportionate interest in the shares. A U.S. Holder's tax basis in the withdrawn shares will be the same as the tax basis in the ADS surrendered therefore, and the holding period in the withdrawn shares will include the period during which the holder held the surrendered ADS.

Dividends. Any cash distributions paid by us out of our earnings and profits, as determined under United States federal income tax principles, will be subject to tax as ordinary dividend income and will be includible in the gross income of a U.S. Holder upon receipt. Cash distributions paid by us in excess of our earnings and profits will be treated as a tax-free return of capital to the extent of the U.S. Holder's adjusted tax basis in our shares or ADSs, and after that as gain from the sale or exchange of a capital asset. Dividends paid in Hong Kong dollars will be includible in income in a United States dollar amount based on the United States dollar to Hong Kong dollar exchange rate prevailing at the time of receipt of such dividends by the depository, in the case of ADSs, or by the U.S. Holder, in the case of shares held directly by such U.S. Holder. U.S. Holders should consult their tax advisors regarding the United States federal income tax treatment of any foreign currency gain or loss recognized on the subsequent conversion of Hong Kong dollars received as dividends to United States dollars. Dividends received on shares or ADSs will not be eligible for the dividends received deduction allowed to corporations.

Under current law, "qualified dividend income" received by an

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individual for taxable years beginning after December 31, 2002 and for taxable years beginning before January 1, 2009 is subject to United States federal income tax rates lower than those applicable to ordinary income. The top federal income tax rate on such qualified dividend income received by an individual is 15%, or 5% for those individuals whose incomes fall in the 10 or 15% brackets. Based upon our existing and anticipated future operations and current assets, we believe that we are a "qualified foreign corporation" and that our dividends paid to U.S. Holders who are individuals will be eligible to be treated as "qualified dividend income" provided that such U.S. Holders satisfy applicable holding period requirements with respect to the ADSs and other applicable requirements. Dividends paid by foreign corporations that are classified as PFICs are not eligible to be treated as "qualified dividend income". See "PFIC Considerations" below.

Dividends received on shares or ADSs will be treated, for United States federal income tax purposes, as foreign source income. A U.S. Holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any foreign withholding taxes imposed on dividends received on shares or ADSs. U.S. Holders who do not elect to claim a foreign tax credit for federal income tax withheld may instead claim a deduction, for United States federal income tax purposes, in respect of such withholdings, but only for a year in which the U.S. Holder elects to do so for all creditable foreign income taxes.

In addition, the United States Treasury has expressed concerns that parties to whom depositary shares are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by the holders of ADSs. Accordingly, the analysis of the creditability of foreign withholding taxes could be affected by future actions that may be taken by the United States Treasury.

Sale or Other Disposition of Shares or ADSs. A U.S. Holder will recognize capital gain or loss upon the sale or other disposition of shares or ADSs in an amount equal to the difference between the amount realized upon the disposition and the U.S. Holder's adjusted tax basis in such shares or ADSs, as each is determined in U.S. dollars. Any such capital gain or loss will be long-term if the shares or ADSs have been held for more than one year and will generally be United States source gain or loss. The claim of a deduction in respect of a capital loss, for United States federal income tax purposes, may be subject to limitations. If a U.S. Holder receives Hong Kong dollars for any such disposition, such U.S. Holder should consult its tax advisor regarding the United States federal income tax treatment of any foreign currency gain or loss recognized on the subsequent conversion of the Hong Kong dollars to United States dollars.

119

### PFIC Considerations

If we were to be classified as a PFIC in any taxable year, a U.S. Holder would be subject to special rules generally intended to reduce or eliminate any benefits from the deferral of United States federal income tax that a U.S. Holder could derive from investing in a foreign company that does not distribute all of its earnings on a current basis. In such event, a U.S. Holder of the shares or ADSs may be subject to tax at ordinary income tax rates on (i) any gain recognized on the sales of the shares or ADSs and (ii) any "excess distribution" paid on the shares or ADSs (generally, a distribution in excess of 125% of the average annual distributions paid by us in the three preceding taxable years). In addition, a U.S. Holder may be

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subject to an interest charge on such gain or excess distribution. Prospective investors are urged to consult their tax advisors regarding the potential tax consequences to them if we are or do become a PFIC, as well as certain elections that may be available to them to mitigate such consequences.

### Non-U.S. Holders

An investment in shares or ADSs by a Non-U.S. Holder will not give rise to any United States federal income tax consequences unless:

- o the dividends received or gain recognized on the sale of the shares or ADSs by such person is treated as effectively connected with the conduct of a trade or business by such person in the United States as determined under United States federal income tax law, or
- o in the case of gains recognized on a sale of shares or ADSs by an individual, such individual is present in the United States for 183 days or more and certain other conditions are met.

In order to avoid back-up withholding on dividend payments made in the United States, a Non-U.S. Holder of the shares or ADSs may be required to complete, and provide the payer with, an Internal Revenue Service Form W-8BEN, or other documentary evidence, certifying that such holder is an exempt foreign person.

### F. DIVIDENDS AND PAYING AGENTS

Not applicable.

### G. STATEMENT BY EXPERTS

Not applicable.

### H. DOCUMENTS ON DISPLAY

We are also subject to the informational requirements of the Exchange Act and accordingly file reports and other information with the Securities and Exchange Commission. You may inspect and copy our reports and other information we file with the Securities and Exchange Commission at the public reference facilities maintained by the Securities and Exchange Commission at Judiciary Plaza, 450 Fifth Street, Room 1024, N.W., Washington, D.C. 20549. You may also inspect such documents at the office of the New York Stock Exchange, Wall Street, New York, New York 10005. Copies of such material may also be obtained from the Public Reference Section of the Securities and Exchange Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may obtain information regarding the Washington D.C. Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330 or by contacting the Securities and Exchange Commission over the internet at its website at <http://www.sec.gov>.

### I. SUBSIDIARY INFORMATION

Not applicable.

### ITEM 11. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

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Our market risk exposures primarily consists of fluctuations in oil and gas prices, exchange rates and interest rates.

### Commodity Price Risks

We are exposed to fluctuations in prices of crude oil and natural gas, which are commodities whose prices are determined by reference to international market prices. International oil and gas prices are volatile and this volatility has a significant effect on our net sales and net income. We do not hedge market risk resulting from fluctuations in oil and gas prices. See "Overview" and "Item 3--Key Information--Risk Factors--Risks relating to our business--Our business, revenues and profits fluctuate with changes in oil and gas prices."

### Currency Risk

Our foreign exchange exposure gives rise to market risk associated with exchange rate movements.

Substantially all of our oil and gas sales are denominated in Renminbi and U.S. dollars. In the last ten years, the PRC government's policy of maintaining a stable exchange rate and China's ample foreign reserves have contributed to the stability of the Renminbi. Recently, there has been wide expectation in the international market that the Chinese government will deregulate the Renminbi exchange rate. However, the Chinese government has not yet determined if or when the exchange rate will be deregulated. Currently, the Renminbi exchange rate remains stable. In case of any Renminbi exchange rate deregulation going forward, our existing assets denominated in U.S. dollars will face book conversion risks from the appreciation of Renminbi. As we prepaid majority of our Yen-denominated loans in 2002, the balance over Yen-denominated loans as of the end of 2004 was only 810 million yen. Currently, since this outstanding of our Yen loans is hedged against foreign currency swaps, we do not expect any exchange risks relating to Japanese Yen in the future. For a discussion of our currency risk, see "Item 3--Key Information--Risk Factors--Risks relating to the PRC--Government control of currency conversion and future movements in exchange rates may adversely affect our operations and financial condition."

### Interest Rate Risk

We are exposed to interest rate risk arising from our loans. An upward fluctuation in interest rates increases the cost of new debt. We may use interest rate swap transactions, from time to time, to adjust our interest rate exposure when considered appropriate, based on existing and anticipated market conditions.

To balance our overall debt interest structure and to reduce our financial cost benefiting from the low interest rate market environment, during the period from July to September 2003, we arranged for an interest rate swap with three financial institutions by swapping the offering of US\$200 million 10-year global guaranteed notes in 2003 into floating interest rate. After the swap, we received fixed interest rate of 4.125% and paid floating interest rate at LIBOR minus 0.771% (weighted average interest rate). During the first interest swap in November 2003, LIBOR was approximately 1.2%. Through this swap, we made interest savings of US\$2.02 million.

Based on the series of robust economic data announced by the US in late 2003, we believed that the US economy had entered into a rapid growth period, with interest rate taking an upward trend. In January 2004, we captured the opportunity of significant drop of US treasury yield with the US's announcement of the poor performance of certain economic data, and terminated the above interest swap arrangement with net gains of US\$10

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million. This, in addition to the interest savings of US\$2.02 million for the year 2003, resulted in cumulative net gains of US\$12.02 million, representing the reduction of interest rate of the US\$200 million guaranteed notes from 4.125% to 3.53%. As of December 31, 2003, our total outstanding debt, including both foreign currency-denominated and Renminbi-denominated loans, was US\$110.0 million, all of which were fixed rate debts.

121

As of the end of 2004, all of our debts were fixed interest rate debts. The term of the weighted average balance was approximately nine years. The weighted average interest rates of our debts, including the convertible bonds issued in December 2004, was 3.6%.

The following table sets forth additional information about the expected maturity dates of our outstanding debt as of December 31, 2004.

	2005	2006	2007	2008	2009	2010 and after
	----	----	----	----	----	----
	(Rmb in millions, except percentages)					
Long-term debt, including current portion						
Fixed rate.....	24	846	19	--	--	--
Average interest rate.....	8.829%	8.962%	4.100%	--%		
Long-term guaranteed notes						
Fixed rate.....	--	--	--	--	8,164	8,150
Average interest rate.....	3.330%	3.330%	3.330%	3.330%	3.330%	5.664%

The above table takes into account our early repayment of certain loans in 2003. For additional discussions of our market risks, see "Item 3--Key Information--Risk Factors."

### ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

122

## PART II

### ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

### ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS



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### A. MATERIAL MODIFICATIONS TO THE RIGHTS TO SECURITY HOLDERS

None.

### B. USE OF PROCEEDS

Not applicable.

### ITEM 15. CONTROLS AND PROCEDURES

(a) We have carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and designed to ensure that material information relating to us and our consolidated subsidiaries as required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported as and when required.

(b) There were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect these controls subsequent to the date of their evaluation.

### ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Kenneth S. Curtis, our independent non-executive director, is an audit committee financial expert serving on our audit committee. Mr. Curtis is independent as defined in the listing standards of the New York Stock Exchange.

### ITEM 16B. CODE OF ETHICS

Our board of directors adopted a Code of Ethics on August 28, 2003 as a guide to sensitize our senior managers to significant legal and ethical issues and to the mechanisms available to report illegal or unethical conduct. The Code is available on our internet website, [www.cnooltd.com](http://www.cnooltd.com). The Code addresses areas including regulatory compliance, insider trading, market misconduct, conflict of interest, corporate opportunities, protection and proper use of company assets, and public company reporting responsibility. All our senior managers must know and follow these principles of conduct to ensure our business is conducted with integrity and in compliance with the law. Any violation of our Code of Ethics is subject to disciplinary action, up to and including termination.

Our Code of Ethics may be amended, modified or waived only by our board of directors. Any change or waiver, explicit or implicit, with respect to our Code of Ethics must be disclosed to our stockholders either in our annual report or on our internet website, [www.cnooltd.com](http://www.cnooltd.com).

### ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

#### Audit Fees

The aggregate fees billed for professional services rendered by our principal accountant for the audit of our annual financial statements or services that are normally provided by the accountant in

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connection with statutory and regulatory filings or engagements were Rmb 5,790,000 for fiscal year 2003 and Rmb 6,887,000 (US\$832,115) for fiscal year 2004.

### Audit-Related Fees

The aggregate fees billed for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of the our financial statements and are not reported under "Audit Fees" were Rmb 2,044,345 for fiscal year 2003 and Rmb 993,180 (US\$120,000) for fiscal year 2004. The audit-related services provided included accounting advice, transaction support services and advisory to our implementation of Section 404 of the Sarbanes-Oxley Act.

### Tax Fees

The aggregate fees billed for professional service rendered by the principal accountant for tax compliance, tax advice and tax planning were Rmb 778,000 for fiscal year 2003 and Rmb 99,318 (US\$12,000) for fiscal year 2004.

### All other fees

The aggregate fees billed for products and services provided by our principal accountant, other than the services reported above, were Rmb 420,000 for fiscal year 2003 and nil for fiscal year 2004.

### Audit Committee's pre-approval policies and procedures

The audit committee under our board of directors is responsible for the appointment, compensation and oversight of the work of our independent auditor. In 2003, our audit committee adopted a policy calling for the audit committee's pre-approval for the engagement of independent auditor for audit and permitted non-audit services. Our board of directors has also ratified the policy and procedures. Under this audit committee policy, proposed services may be pre-approved by the audit committee either on an annual basis or on a case-by-case basis. Appendices to the audit committee policy sets forth (1) the audit, audit-related, tax and other services that may be subject to the general annual pre-approval of the audit committee; (2) non-audit services of a routine and recurring nature that may be subject to specific pre-approval from the audit committee on a case-by-case basis; and (3) a list of prohibited non-audit services. The audit committee will periodically review and revise these attached lists based on its subsequent determinations. The audit committee policy also provides for procedures to establish annual fee levels or budgets for pre-approved services and ratios between different categories of pre-approved services. In addition, the audit committee policy contains provisions that deal with compliance, monitoring, reporting and other related matters.

During 2004, all of the audit-related services, and all of tax fees paid to our principal accountant were approved by the audit committee. Our principal accountant audited our financial statements for 2004 solely through its full-time, permanent employees, without involvement of its part-time or temporary employees.

### ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

### ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED

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### PURCHASERS

On May 17, 2004, our board of directors approved a management proposal that allowed us to repurchase shares in the open market based on the general mandates approved by shareholders on May 29, 2003 and June 14, 2004. The authorization permits the purchase of up to 10% of the issued share capital on the Hong Kong Stock Exchange in conformity with relevant regulatory conditions. Shares purchased under the program will be canceled. We have made the following purchases:

124

Issuer Purchases of Equity Securities				
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Be Purchased Under the Plan
-----	-----	-----	-----	-----
May 18, 2004	5,427,000	HK\$2.8615	5,427,000	4,101
May 24, 2004	3,450,000	HK\$3.0964	8,877,000	4,098
June 17, 2004	7,140,000	HK\$3.2673	16,017,000	4,099
June 21, 2004	876,000	HK\$3.1329	16,893,000	4,098
July 2, 2004	500,000	HK\$3.275	17,393,000	4,097
July 8, 2004	1,060,000	HK\$3.2882	18,453,000	4,096

125

### PART III

#### ITEM 17. FINANCIAL STATEMENTS

Not applicable.

#### ITEM 18. FINANCIAL STATEMENTS

See pages beginning on page F-1 following Item 19.

#### ITEM 19. EXHIBITS

The following documents are filed as part of this annual report:

Exhibit Number	Document
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- 1.1 Articles of Association of the Registrant, incorporated by reference to Exhibit 1.1 to our annual report on Form 20-F for fiscal year 2003 filed with the Securities and Exchange Commission (File Number: 1-14966).
- 1.2 Memorandum of Association of the Registrant, incorporated by reference to Exhibit 3.2 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 2.1 Form of Indenture, incorporated by reference to Exhibit 2.1 to our Annual Report on Form 20-F filed with the Securities and Exchange Commission (File Number: 1-14966).
- 2.2 Trust Deed dated December 15, 2004 among CNOOC Limited, CNOOC Finance (2004) Limited and J.P. Morgan Corporate Trustee Services Limited.
- 4.1 The Asset Swap Agreement dated July 20, 1999 between CNOOC and Offshore Oil Company Limited, incorporated by reference to Exhibit 10.1 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.2 The Asset Allocation Agreement dated July 20, 1999 between CNOOC and Offshore Oil Company Limited, incorporated by reference to Exhibit 10.2 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.3 The Reorganization Agreement dated September 13, 1999 between CNOOC, Offshore Oil Company Limited and CNOOC Limited, incorporated by reference to Exhibit 10.3 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.4 Form of the Equity Transfer Agreement between CNOOC and CNOOC Limited, incorporated by reference to Exhibit 10.4 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.5 Form of the Transfer Agreement dated October 1, 1999 between CNOOC and Offshore Oil Company Limited regarding the transfer of the rights and obligations of CNOOC under the 37 production sharing contracts and one geophysical exploration agreement, incorporated by reference to Exhibit 10.5 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).

126

Exhibit Number	Document
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4.6	Form of Equity Transfer Agreement between China Offshore Oil East China Sea Corporation and Offshore Oil Company Limited regarding the transfer of the rights and obligations under Joint Venture Contract of Shanghai Petroleum and Natural Gas Company Limited dated July 28, 1992 to Offshore Oil Company Limited, incorporated by reference to Exhibit 10.6 to our Registration Statement on Form F-1 filed with

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the Securities and Exchange Commission (File Number: 333-10862).

- 4.7 Transfer Agreement dated September 9, 1999 between CNOOC and Offshore Oil Company Limited regarding the transfer of the rights and obligations of CNOOC under the Natural Gas Sale and Purchase Contract dated December 22, 1992 to Offshore Oil Company Limited, incorporated by reference to Exhibit 10.7 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.8 Transfer Agreement dated September 9, 1999 between CNOOC and Offshore Oil Company Limited regarding the transfer of the rights and obligations of CNOOC under the Natural Gas Sale and Purchase Contract dated November 7, 1992 to Offshore Oil Company Limited, incorporated by reference to Exhibit 10.8 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.9 Transfer Agreement dated September 9, 1999 among CNOOC, Offshore Oil Company Limited, the four PRC subsidiaries and CNOOC's affiliates regarding the transfer of the rights and obligations of the technical services agreements to Offshore Oil Company Limited, incorporated by reference to Exhibit 10.9 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.10 Nanshan Terminal Leasing Agreement dated September 9, 1999 between CNOOC, Hainan China Oil and Offshore Natural Gas Company and Offshore Oil Company Limited, incorporated by reference to Exhibit 10.10 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.11 Trademark License Agreement dated September 9, 1999 between CNOOC, Offshore Oil Company Limited and CNOOC Limited, incorporated by reference to Exhibit 10.11 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.12 Trademark License Agreement dated September 9, 1999 between China Offshore Oil Marketing Company, CNOOC Limited and Offshore Oil Company Limited and CNOOC Limited, incorporated by reference to Exhibit 10.12 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.13 Agreement for provision of materials, facilities and auxiliary services dated September 9, 1999 with CNOOC affiliates, incorporated by reference to Exhibit 10.13 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).

127

Exhibit Number	Document
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4.14	Agreement for provision of materials, facilities and auxiliary services dated September 9, 1999 with CNOOC affiliates, incorporated by reference to Exhibit 10.14 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number:

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333-10862).

- 4.15 Agreement for provision of materials, facilities and auxiliary services dated September 9, 1999 with CNOOC affiliates, incorporated by reference to Exhibit 10.15 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.16 Agreement for provision of materials, facilities and auxiliary services dated September 9, 1999 with CNOOC affiliates, incorporated by reference to Exhibit 10.16 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.17 General Research and Development Agreement dated September 9, 1999 between China Ocean Oil Research Institute and Offshore Oil Company Limited, incorporated by reference to Exhibit 10.17 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.18 Property Leasing Agreement dated September 9, 1999 between Wui Hai Enterprise Company Limited and Offshore Oil Company Limited in respect of the office premises at 6th, 7th and 8th Floors, CNOOC Plaza, No. 6 Dong Zhi Men Wai Xiao Jie, Beijing, incorporated by reference to Exhibit 10.18 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.19 Property Leasing Agreement dated September 9, 1999 between China Offshore Oil Western South China Sea Corporation and Offshore Oil Company Limited in respect of the office premises at 1st to 9th Floors, Nantiao Road, Potou District Zhangjiang, Guangdong, incorporated by reference to Exhibit 10.19 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.20 Property Leasing Agreement dated September 9, 1999 between China Offshore Oil Bohai Corporation and Offshore Oil Company Limited in respect of the office premises at 1st to 7th Floors and 9th Floor, 2-37 He Kou Jie, Tanggu District, Tianjin, incorporated by reference to Exhibit 10.20 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.21 Property Leasing Agreement dated September 9, 1999 between China Offshore Oil East China Sea Corporation and Offshore Oil Company Limited in respect of the office premises at 20th, 22nd and 23rd Floors, 583 Ling Ling Road, Shanghai, the PRC, incorporated by reference to Exhibit 10.21 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
- 4.22 Property Leasing Agreement dated September 9, 1999 between China Offshore Oil Eastern South China Sea Corporation and Offshore Oil Company Limited in respect of the office premises at 3rd Floor and 6th to 11th Floors, 1 Second Industrial Road, Shekou, Shenzhen, the PRC, incorporated by reference to Exhibit 10.22 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).

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Exhibit Number -----	Document -----
4.23	Property Leasing Agreement dated September 9, 1999 between China Offshore Oil Bohai Corporation and Offshore Oil Company Limited in respect of the Chengbei Warehouse, Chengbei Road, Tanggu District, Tianjin City, the PRC, incorporated by reference to Exhibit 10.23 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.24	Property Leasing Agreement dated September 9, 1999 between Overseas Oil & Gas Corporation Ltd. and China Offshore Oil (Singapore) International Pte. Ltd. in respect of the residential premises at 10-01 and 17-002 Aquamarine Tower, 50 Bayshore Road, 13-05 Jade Tower, 60 Bayshore Road, Singapore, incorporated by reference to Exhibit 10.24 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.25	Suizhong Pier Agreement dated September 9, 1999 between Offshore Oil Company Limited and China Offshore Bohai Corporation, incorporated by reference to Exhibit 10.25 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.26	Form of Novation Agreement among CNOOC, CNOOC China Limited, the Banks and other financial institution and the Fuji Bank Limited Hong Kong Branch, as agent, in respect of the transfer of the US\$110 million syndicated loan, incorporated by reference to Exhibit 10.26 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.27	Form of the Undertaking Agreement between CNOOC and CNOOC Limited, incorporated by reference to Exhibit 10.27 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.28	Employment Contract between CNOOC Limited and Liucheng Wei (Service Agreement for Director, incorporated by reference to Exhibit 10.28 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.29	Employment Contract between CNOOC Limited and Chengyu Fu (Service Agreement for Director, incorporated by reference to Exhibit 10.29 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.30	Employment Contract between CNOOC Limited and Shouwei Zhou (Service Agreement for Director, incorporated by reference to Exhibit 10.30 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.31	Form of Pre-Global Offering Share Option Scheme for the Senior Management of CNOOC Limited, incorporated by reference to Exhibit 10.31 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.32	Form of Share Option Scheme for the Senior Management of CNOOC Limited, incorporated by reference to Exhibit 10.32 to our Registration Statement on Form F-1 filed with the Securities and

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Exchange Commission (File Number: 333-10862).

129

Exhibit Number -----	Document -----
4.33	Subscription Agreement dated March 17, 2000 among CNOOC Limited, CNOOC (BVI) Limited, Overseas Oil & Gas Corporation, Ltd., et al., incorporated by reference to Exhibit 10.33 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.34	Subscription Agreement dated May 31, 2000 among CNOOC Limited, CNOOC (BVI) Limited, Overseas Oil & Gas Corporation, Ltd. and Hutchison International Limited, incorporated by reference to Exhibit 10.34 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.35	Subscription Agreement dated May 31, 2000 among CNOOC Limited, CNOOC (BVI) Limited, Overseas Oil & Gas Corporation, Ltd. and Hongkong Electric Holdings Limited, incorporated by reference to Exhibit 10.35 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.36	Subscription Agreement dated June 28, 2000 among CNOOC Limited, CNOOC (BVI) Limited, Overseas Oil & Gas Corporation, Ltd., et al., incorporated by reference to Exhibit 10.36 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.37	Corporation Placing Agreement dated February 6, 2001 among CNOOC Limited, China National Offshore Oil Corporation, Shell Eastern Petroleum (Pte) Limited and Merrill Lynch Far East Limited, incorporated by reference to Exhibit 10.37 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission (File Number: 333-10862).
4.38	Equity Transfer Agreement dated September 5, 2003 between CNOOC China Limited and CNOOC (Summary Translation), incorporated by reference to Exhibit 4.38 to our annual report on Form 20-F for fiscal year 2003 filed with the Securities and Exchange Commission (File Number: 1-14966).
4.39	Framework Agreement dated April 8, 2004 with CNOOC Finance Corporation Limited (Summary Translation), incorporated by reference to Exhibit 4.39 to our annual report on Form 20-F for fiscal year 2003 filed with the Securities and Exchange Commission (File Number: 1-14966).
8.1	List of Subsidiaries.
10.1	Letter from CNOOC Limited dated May 23, 2002 regarding receipt of certain representations from Arthur Andersen & Co pursuant to the requirements of the Securities and Exchange Commission, incorporated by reference to Exhibit 10 to our annual report on Form 20-F for fiscal year 2001 filed with the Securities and Exchange Commission (File Number: 1-14966).



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- 12.1 Certification by the Chief Executive Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002
- 12.2 Certification by the Chief Financial Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002
- 13.1 Sarbanes-Oxley Act of 2002 Section 906 Certification furnished to (not filed with) the Securities and Exchange Commission.

130

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

CNOOC Limited

By: /s/ Yunshi Cao

-----  
Name: Yunshi Cao  
Title: Company Secretary,  
General Counsel and  
Senior Vice President

Date: June 22, 2005

131

CNOOC LIMITED AND ITS SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002  
TOGETHER WITH REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

F-1

INDEX TO FINANCIAL STATEMENTS

CNOOC LIMITED AND ITS SUBSIDIARIES  
Report of Independent Public Accountants.....

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Consolidated income statements for the years ended December 31, 2004, 2003,  
and 2002.....  
Consolidated balance sheets as of December 31, 2004 and 2003.....  
Consolidated statements of changes in equity for the years ended December 31, 2004, 2003,  
and 2002.....  
Consolidated cash flow statements for the years ended December 31, 2004,  
2003, and 2002.....  
Notes to the consolidated financial statements.....

F-2

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholders of  
CNOOC Limited  
(Incorporated in Hong Kong with limited liability)

We have audited the accompanying consolidated balance sheets of CNOOC Limited (the "Company") and its subsidiaries (the "Group") as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the years ended December 31, 2004, 2003 and 2002. These financial statements are the responsibility of the management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and Statement of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2004 and 2003 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in Hong Kong ("Hong Kong GAAP").

Accounting principles generally accepted in Hong Kong vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 37 to the consolidated financial statements.

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/s/ Ernst & Young

Ernst & Young  
Certified Public Accountants

Hong Kong  
March 29, 2005

F-3

CNOOC LIMITED AND ITS SUBSIDIARIES  
CONSOLIDATED INCOME STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

	Notes	2002	2003
		RMB'000	RMB'000
<b>REVENUE</b>			
Oil and gas sales	7,26	23,779,294	28,116,831
Marketing revenues	8	2,377,469	12,398,661
Other income		217,052	434,781
		26,373,815	40,950,273
<b>EXPENSES</b>			
Operating expenses		( 3,775,334)	( 4,512,809)
Production taxes		( 1,023,049)	( 1,238,598)
Exploration expenses		( 1,318,323)	( 848,072)
Depreciation, depletion and amortisation		( 4,019,532)	( 4,642,753)
Dismantlement	27	( 126,139)	( 167,326)
Crude oil and product purchases	8	( 2,326,338)	( 12,295,238)
Selling and administrative expenses	9	( 1,006,540)	( 1,212,523)
Others		( 30,866)	( 350,232)
		( 13,626,121)	( 25,267,551)
<b>PROFIT FROM OPERATING ACTIVITIES</b>		<b>12,747,694</b>	<b>15,682,722</b>
Interest income		147,870	183,576
Interest expenses	10	( 294,792)	( 354,940)
Exchange gains/(losses), net		( 113,814)	( 6,746)
Short term investment income		193,277	123,483
Share of profit of associates		165,387	220,263
Non-operating income/(expenses), net		( 71,379)	314,968

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PROFIT BEFORE TAX		12,774,243	16,163,326
Tax	13	( 3,541,416)	( 4,627,836)
NET PROFIT		9,232,827	11,535,490

The accompanying notes are an integral part of these financial statements.

F-4

CNOOC LIMITED AND ITS SUBSIDIARIES  
CONSOLIDATED INCOME STATEMENTS (CONT'D)  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

	Notes	2002	2003
		RMB'000	RMB'000
DIVIDENDS			
Special interim dividend declared in place of 2003 final dividend *		--	--
Interim	14	958,314	1,220,132
Special interim	14	--	1,568,741
Proposed final*	14	1,307,408	1,050,460
Proposed special final*	14	1,307,408	1,575,691
		3,573,130	5,415,024
DIVIDENDS PER SHARE			
Special interim dividend declared in place of 2003 final dividend*		--	--
Interim	14	RMB0.024	RMB0.030
Special interim	14	--	RMB0.038
Proposed final*	14	RMB0.032	RMB0.026
Proposed special final*	14	RMB0.032	RMB0.038
EARNINGS PER SHARE			
Basic	15	RMB0.22	RMB0.28
Diluted	15	RMB0.22	RMB0.28
EARNINGS PER ADS			
Basic	15	RMB22.48	RMB28.09
Diluted	15	RMB22.47	RMB28.06

\* The proposed final dividend and special final dividend for 2003 were cancelled and replaced by the special interim dividend declared in 2004.

The accompanying notes are an integral part of these financial statements.

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F-5

CNOOC LIMITED AND ITS SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	Notes	2003	
		RMB '000	R
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment, net	16	43,123,801	5
Investments in associates	17	1,117,640	
		-----	-----
		44,241,441	5
		-----	-----
<b>CURRENT ASSETS</b>			
Accounts receivable, net	18	4,248,570	
Inventories and supplies	19	1,092,926	
Due from related companies	26	756,283	
Other current assets		757,355	
Short term investments	20	5,684,333	
Time deposits with maturities over three months		2,323,000	
Cash and cash equivalents	26	14,400,394	1
		-----	-----
		29,262,861	3
		-----	-----
<b>TOTAL ASSETS</b>		73,504,302	9
		=====	=====
<b>CURRENT LIABILITIES</b>			
Accounts payable	21	3,969,922	
Other payables and accrued liabilities	22	1,955,783	
Current portion of long term bank loans	23	20,618	
Due to the parent company	25, 26	164,653	
Due to related companies	26	474,223	
Tax payable	13	2,721,331	
		-----	-----
		9,306,530	1
		-----	-----
<b>NON-CURRENT LIABILITIES</b>			
Long term bank loans	23	889,575	
Long term guaranteed notes	24	8,141,669	1
Provision for dismantlement	27	2,646,800	
Deferred tax liabilities	13	5,783,196	
		-----	-----
		17,461,240	2
		-----	-----
<b>CAPITAL AND RESERVES</b>			
Issued capital	28	876,978	
Reserves	29	45,859,554	5

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	46,736,532	5
TOTAL EQUITY AND LIABILITIES	73,504,302	9

The accompanying notes are an integral part of these financial statements.

F-6

CNOOC LIMITED AND ITS SUBSIDIARIES  
STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

	Share capital	Share premium	Revaluation reserve	Cumulative translation reserve	Statut and n distribut rese
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'
Balances at January 1, 2002 as previously stated	876,978	20,761,205	274,671	( 5,648)	1,535,
Cumulative effect of change in accounting policy	-	-	-	-	-
Balances at January 1, 2002 as restated	876,978	20,761,205	274,671	( 5,648)	1,535,
Net profit for the year	-	-	-	-	-
Appropriation to statutory reserve	-	-	-	-	697,
Dividends	-	-	-	-	-
Foreign currency translation differences	-	-	-	( 7,948)	-
Net losses not recognised in the income statement	-	-	-	( 7,948)	-
Balances at January 1, 2003	876,978	20,761,205	274,671	(13,596)	2,232,
Net profit for the year	-	-	-	-	-
Appropriation to statutory reserve	-	-	-	-	818,
Dividends	-	-	-	-	-
Transfer to / (from) reserve	-	-	-	-	5,000,
Foreign currency translation differences	-	-	-	36,243	-
Net gains not recognised in the income statement	-	-	-	36,243	-
Balances at January 1, 2004	876,978	20,761,205	274,671	22,647	8,050,
Repurchase of shares (note 28)	( 392)	-	-	-	-

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Transfer of reserves upon shares repurchase (note 28)	-	392	-	-	
Net profit for the year	-	-	-	-	
Appropriation to statutory reserve	-	-	-	-	1,363,
Dividends (note 14)	-	-	-	-	
Foreign currency translation differences	-	-	-	( 42,301)	
Net losses not recognised in the income statement	-----	-----	-----	-----	-----
	-	-	-	( 42,301)	
Balances at December 31, 2004	=====	=====	=====	=====	=====
	876,586	20,761,597	274,671	( 19,654)	9,413,

\* These reserve accounts comprise the consolidated reserves of RMB55,840,875,000 (2003: RMB45,859,554,000; 2002: RMB39,691,510,000) in the consolidated balance sheet.

The accompanying notes are an integral part of these financial statements.

F-7

CNOOC LIMITED AND ITS SUBSIDIARIES  
CONSOLIDATED CASH FLOW STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

	Notes	2002	2003	
	-----	-----	-----	-----
		RMB'000	RMB'000	
<b>OPERATING ACTIVITIES</b>				
Cash generated from operations	31(a)	17,406,915	21,142,911	
Income taxes paid		( 3,013,279)	( 3,514,807)	(
Income tax refund		167,065	-	
Interest received		147,870	183,576	
Dividends received		90,000	90,000	
Short term investments income received		79,679	55,840	
Interest paid		( 136,222)	( 138,801)	(
		-----	-----	-----
Net cash inflow from operating activities		14,742,028	17,818,719	
<b>INVESTING ACTIVITIES</b>				
Acquisition of and prepayment for oil and gas properties	31(b)	( 4,734,174)	( 4,100,900)	(
Additions of property, plant and equipment		( 6,832,746)	( 8,271,564)	(
Proceeds from disposals of property, plant and equipment		446	-	
Investment in an associate		-	( 450,000)	(

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(Increase)/decrease in time deposits with maturities over three months	( 2,640,000)	2,367,000	(
Additions of short term investments	( 3,399,413)	( 8,144,702)	(
Disposals of short term investments	5,882,305	9,087,581	
	-----	-----	
Net cash outflow from investing activities	(11,723,582)	( 9,512,585)	(
	-----	-----	
FINANCING ACTIVITIES			
Issue of long term guaranteed notes	4,059,345	3,995,773	
Repayment of bank loans	( 3,367,347)	( 336,938)	(
Dividends paid	( 2,265,054)	( 5,403,689)	(
Share repurchases	-	-	(
	-----	-----	
Net cash inflow/(outflow) from financing activities	( 1,573,056)	( 1,744,854)	
	-----	-----	
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,445,390	6,561,280	(
	-----	-----	
Cash and cash equivalents at beginning of year	6,393,724	7,839,114	
	-----	-----	
CASH AND CASH EQUIVALENTS AT END OF YEAR	7,839,114	14,400,394	
	-----	-----	
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	7,839,114	14,400,394	
	-----	-----	

The accompanying notes are an integral part of these financial statements.

F-8

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

1. CORPORATE INFORMATION

CNOOC Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("Hong Kong"), the People's Republic of China (the "PRC") on August 20, 1999 to hold the interests in certain entities whereby creating a group comprising the Company and its subsidiaries. During the year, the Company and its subsidiaries (hereinafter collectively referred to as the "Group") were principally engaged in the exploration, development, production and sale of crude oil, natural gas and other petroleum products.

The registered office address is 65/F, Bank of China Tower, Garden Road, Hong Kong.



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In the opinion of the directors, the ultimate holding company is China National Offshore Oil Corporation ("CNOOC"), a company established in the PRC.

Particulars of the principal subsidiaries are as follows:

Name -----	Place and date of incorporation/ registration and operations -----	Nominal value of issued ordinary share capital -----	Percentage of equity attributable to the Company -----
Directly held subsidiaries:			
CNOOC China Limited	Tianjin, the PRC September 15, 1999	RMB15 billion	100%
CNOOC International Limited	British Virgin Islands August 23, 1999	US\$2	100%
China Offshore Oil (Singapore) International Pte., Ltd.	Singapore May 14, 1993	S\$3 million	100%
CNOOC Finance (2002) Limited	British Virgin Islands January 24, 2002	US\$1,000	100%
CNOOC Finance (2003) Limited	British Virgin Islands April 2, 2003	US\$1,000	100%
CNOOC Finance (2004) Limited	British Virgin Islands December 9, 2004	US\$1,000	100%
Indirectly held subsidiaries*:			
Malacca Petroleum Limited	Bermuda November 2, 1995	US\$12,000	100%

F-9

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

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1. CORPORATE INFORMATION (CONT'D)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary share capital	Percentage of equity attributable to the Company
-----	-----	-----	-----
Indirectly held subsidiaries* (cont'd):			
OOGC America, Inc.	State of Delaware, United States of America September 2, 1997	US\$1,000	100%
OOGC Malacca Limited	Bermuda November 2, 1995	US\$12,000	100%
CNOOC Southeast Asia Limited	Bermuda May 16, 1997	US\$12,000	100%
CNOOC ONWJ Ltd.	Labuan, F.T., Malaysia March 27, 2002	US\$1	100%
CNOOC SES Ltd.	Labuan, F.T., Malaysia March 27, 2002	US\$1	100%
CNOOC Poleng Ltd.	Labuan, F.T., Malaysia March 27, 2002	US\$1	100%
CNOOC Madura Ltd.	Labuan, F.T., Malaysia March 27, 2002	US\$1	100%
CNOOC Blora Ltd.	Labuan, F.T., Malaysia March 27, 2002	US\$1	100%

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CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

1. CORPORATE INFORMATION (CONT'D)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary share capital	Percentage of equity attributable to the Company
Indirectly held subsidiaries* (cont'd):			
CNOOC NWS Private Ltd.	Singapore October 8, 2002	S\$1	100%
CNOOC Wiriagar Overseas Ltd.	British Virgin Islands January 15, 2003	US\$1	100%
CNOOC Muturi Ltd.	The Isle of Man February 8, 1996	US\$7,780,700	100%

\* Indirectly held through CNOOC International Limited.

2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after January 1, 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended December 31, 2004. The Group has already commenced an assessment of the impact of these new HKFRSs, but is not yet in a position to state when these new HKFRSs would have a significant impact on its results of operations and financial position.

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CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of preparation

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These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong ("Hong Kong GAAP") and the Companies Ordinance. They have been prepared under the historical cost convention as modified by the revaluation of land and buildings and short term investments.

On March 16, 2004, the Company's shareholders approved a five-for-one stock split of the Company's shares (the "Stock Split"). The Stock Split was effected by dividing each of the Company's 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 Stock Exchange of Hong Kong Limited (the "HKSE") from 500 shares of HK\$0.10 each to 1,000 subdivided shares of HK\$0.02 each. The ratio of the Company's American Depository Receipts ("ADR") listed on the New York Stock Exchange also changed such that each ADR now represents 100 subdivided common shares of HK\$0.02 each, as opposed to 20 common shares of HK\$0.10 each prior to the Stock Split. All references in the consolidated financial statements referring to share, share option and per share amounts of the shares of the Company have been adjusted retroactively for the Stock Split.

#### Basis of consolidation

-----

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended December 31, 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

#### Subsidiaries

-----

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

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### NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

##### Associates

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An associate is a company, not being a subsidiary or a jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of the associate is included in the consolidated income statement and consolidated reserves, respectively. The Group's proportionate interests in the associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. The results of the associates are included in the Company's income statement to the extent of dividends received and receivable.

##### Related parties

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Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

##### Impairment of assets

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An assessment is made whenever events or changes in circumstances indicate that there is any indication of impairment of any assets, or when there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised 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.

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Property, plant and equipment  
-----

Property, plant and equipment comprise oil and gas properties, land and buildings, and vehicles and office equipment.

(i) Oil and gas properties

For oil and gas properties, the successful efforts method of accounting is adopted. The Group capitalises initial acquisition costs of oil and gas properties. Impairment of initial acquisition costs is recognised based on exploratory experience and management judgement. Upon discovery of commercial reserves, acquisition costs are transferred to proved properties. The costs of drilling and equipping successful exploratory wells, all development costs, including those renewals and betterments which extend the economic lives of the assets, and the borrowing costs arising from borrowings used to finance the development of oil and gas properties before they are substantially ready for production are capitalised. The costs of unsuccessful exploratory wells and all other exploration costs are expensed as incurred.

Exploratory wells are evaluated for economic viability within one year of completion. Exploratory wells that discover potentially economic reserves in areas where major capital expenditure will be required before production would begin and when the major capital expenditure depends upon successful completion of further exploratory work remain capitalised and are reviewed periodically for impairment.

Productive oil and gas properties and other tangible and intangible costs of producing properties are amortised using the unit-of-production method on a property-by-property basis under which the ratio of produced oil and gas to the estimated remaining proved developed reserves is used to determine the depreciation, depletion and amortisation provision. Costs associated with significant development projects are not depleted until commercial production commences and the reserves related to those costs are excluded from the calculation of depletion.

Capitalised acquisition costs of proved properties are amortised by the unit-of-production method on a property-by-property basis computed based on the total estimated units of proved reserves.

The Group estimates 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 capitalised and the liability is discounted and an accretion expense

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is recognised using the credit-adjusted risk-free interest rate in effect when the liability is initially recognised.

F-14

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

#### Property, plant and equipment (cont'd)

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##### (ii) Land and buildings

Land and buildings represent the onshore buildings and the land use rights and are stated at valuation less accumulated depreciation and accumulated impairment losses. Professional valuations are performed periodically with the last valuation performed on December 31, 2000. In the intervening years, the directors review the carrying value of land and buildings and adjustment is made where in the directors' opinion there has been a material change in value. Any increase in land and building valuation is credited to the revaluation reserves; any decrease is first offset against an increase in earlier valuation in respect of the same property and is thereafter charged to the income statement. Depreciation is calculated on the straight-line basis at an annual rate estimated to write off the valuation of each asset over its expected useful life, ranging from 30 to 50 years.

##### (iii) Vehicles and office equipment

Vehicles and office equipment are stated at cost less accumulated depreciation and impairment losses. The straight-line method is adopted to depreciate the cost less any estimated residual value of these assets over their expected useful lives. The Group estimates the useful lives of vehicles and office equipment to be five years.

The useful lives of assets and method of depreciation, depletion and amortisation are reviewed periodically.

The gain or loss on disposal or retirement of property, plant and equipment recognised in the income statement is the difference between the net sales proceeds and the carrying amount of the relevant asset. Any revaluation reserve relating to the fixed asset is transferred to retained earnings as a reserve movement.

#### Research and development costs

-----

All research costs are charged to the income statement as incurred.

Development costs (other than relating to oil and gas properties discussed above) incurred on projects are capitalised and deferred only when the projects are clearly defined; the expenditures are separately identifiable and can be measured reliably; there is reasonable certainty

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that the projects are technically feasible and have commercial value. Development expenditure which does not meet these criteria is expensed when incurred. No development costs were capitalised during the year.

Trade and other receivables  
-----

Trade and other receivables are stated at their cost, after provision for doubtful accounts.

F-15

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Short term investments  
-----

Short term investments are investments in debt and equity securities not intended to be held on a continuing basis and are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security are credited or charged to the income statement in the period in which they arise.

Inventories and supplies  
-----

Inventories consisting primarily of oil and supplies consist mainly of items for repairs and maintenance of oil and gas properties. Inventories are stated at the lower of cost and net realisable value. Costs of inventories and supplies represent purchase or production cost of goods and are determined on a weighted average basis. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal. Supplies are capitalised to property, plant and equipment when used for renewals and betterments of oil and gas properties and have resulted in an increase in the future economic values of oil and gas properties or are recognised as expenses when used.

Cash and cash equivalents  
-----

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are payable on demand and form an integral part of the Group's cash management. For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, and term deposits with maturities of three months or less which are not restricted to use.

Provisions  
-----



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A provision is recognised 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, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised 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 interest expenses in the income statement.

Provisions for dismantlement are made based on the present value of the future costs expected to be incurred, on a property-by-property basis, in respect of the Group's expected dismantlement and abandonment costs at the end of the related oil exploration and recovery activities.

F-16

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

#### Income tax -----

Income tax comprises current and deferred tax. Income tax is recognised in the income statement or in equity if it relates to items that are recognised in same or a different period directly in equity.

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.

Deferred tax liabilities are recognised for all taxable temporary differences:

- o except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- o in respect of taxable temporary differences associated with investments in subsidiaries and associates, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

- o except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- o in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantially enacted at the balance sheet date.

F-17

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Revenue recognition  
-----

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(i) Oil and gas sales

Revenues represent the invoiced value of sales of oil and gas attributable to the interests of the Group, net of royalties and PRC government share oil that are lifted and sold on behalf of the PRC government. Sales are recognised when the significant risks and rewards of ownership of oil and gas have been transferred to customers.

Oil and gas lifted and sold by the Group above or below the Group's participating interests in the production sharing contracts results in overlifts and underlifts. The Group records 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 equalised or in cash when production ceases.

The Group has entered into gas sales contracts with customers which contains take-or-pay clauses. The clauses require those customers to take a specified minimum volume of gas each year. If the minimum volume of gas is not taken, those customers must pay for the deficiency gas, even though the gas is not taken. Those customers

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can offset the deficiency payment against any future purchases in excess of the specified volume. The Group records any deficiency payments as deferred revenue which is included in other payables until any make-up gas is taken by those customers or the expiry of the contracts.

### (ii) Marketing revenues

Marketing revenues represent sales of oil purchased from the foreign partners under the production sharing contracts and revenues from the trading of oil through the Company's subsidiary in Singapore. The title, together with the risks and rewards of the ownership of such oil purchased from the foreign partners, is transferred to the Group from the foreign partners and other unrelated oil and gas companies before the Group sells such oil to its customers. The cost of the oil sold is included in crude oil and product purchases.

### (iii) Other income

Other income mainly represents project management fees charged to the foreign partners and handling fees charged to customers and is recognised when the services are rendered.

### (iv) Interest income

Interest income from deposits placed with banks and other financial institutions is recognised on a time proportion basis taking into account the effective yield on the assets.

### (v) Dividend income

Dividend income is recognised when the right to receive payment has been established.

F-18

## CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

#### Retirement and termination benefits -----

The Group participates in defined contribution plans based on local laws and regulations for full-time employees in the PRC and other countries in which it operates. The plans provide for contributions ranging from 5% to 22% of the employees' basic salaries. The Group's contributions to these defined contribution plans are charged to expense in the year to which they relate.

#### Share option schemes -----

The Company operates share option schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options

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granted under the share option schemes is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the income statement or balance sheet for their cost. Upon the exercise of share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding options.

### Dividends

-----

Final and special final dividends proposed by the directors are classified as a separate allocation of retained earnings within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim and special interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

### Borrowing costs

-----

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e. assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset is determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

F-19

## CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

#### Borrowing costs (cont'd)

-----

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate is the weighted

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average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised incurred during a period should not exceed the amount of borrowing cost incurred during that period.

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, including amortisation of discounts or premiums relating to borrowings, and amortisation of ancillary costs incurred in connection with arranging borrowings.

### Foreign currencies

-----

The books and records of the Company and its subsidiary in China are maintained in Renminbi ("RMB"). Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the income statement.

On consolidation, the financial statements of overseas subsidiaries are translated into RMB using the net investment method. The income statements of overseas subsidiaries are translated into RMB at the weighted average exchange rates for the year, and their balance sheets are translated into RMB at the exchange rates ruling at the balance sheet date. The resulting translation differences are included in the cumulative translation reserve.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

### Convenience Translation

-----

Translations of amounts from RMB into United States dollars for the convenience of the reader were calculated at the noon buying rate of US\$1.00 to RMB8.2765 on December 31, 2004 in the City of New York for cable transfers of RMB as certified for customs purpose by the Federal Reserve Bank of New York. No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at such rate.

### Repairs, maintenance and overhaul costs

-----

Repairs, maintenances and overhaul costs are normally charged to the income statement as operating expenses in the period in which they are incurred.

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(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

#### Financial instruments -----

The Group has interest rate and currency swap contracts with financial institutions. Those financial instruments not designated as hedging instruments are carried at fair value, with any changes in fair value thereof included in the income statement.

#### Operating leases -----

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Company is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

#### Contingencies -----

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised in the financial statements, but are disclosed when an inflow of economic benefits is probable.

#### Subsequent events -----

Post-year-end events that provide additional information about the Company's position at the balance sheet date or those that indicate the going concern assumption is not appropriate (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

#### Use of estimates -----

The preparation of financial statements in conformity with Hong Kong GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

### 4. ACQUISITIONS

- (i) In 2003, the Company acquired from British Petroleum ("BP") an equivalent of 12.5% interest in the proposed joint venture known as the Tangguh LNG Project of Indonesia ("Tangguh LNG Project") for approximately US\$275 million (equivalent to approximately RMB2,276,578,000) through the acquisition of certain interest in production sharing contracts ("PSCs") which was effective from January 1, 2003. The Tangguh LNG Project comprises three PSC areas: the Berau PSC, the Muturi PSC and the Wiriagar PSC. The Tangguh LNG Project partners have signed a conditional 25-year Liquefied Natural Gas ("LNG") Supply Contract (the "LNG Supply Contract") to provide up to 2.6 million tonnes per annum of LNG to the Fujian LNG project

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in the PRC, beginning in 2008. The Company completed the Tangguh acquisition on February 8, 2003. CNOOC has an equity interest in the Fujian LNG project.

F-21

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 4. ACQUISITIONS

In addition, a repurchase agreement (the "Repurchase Agreement") was entered into whereby put options and call options are granted to the Company and the sellers, respectively, to sell or to repurchase the interests in the above mentioned PSCs. The options are exercisable if:

- (1) the LNG Supply Contract is terminated due to the non-satisfaction of the conditions precedent to the LNG Supply Contract on or before December 31, 2004; or
- (2) the LNG Supply Contract is otherwise legally ineffective on or before December 31, 2004.

The exercise price of the options are determined based on the original consideration paid plus adjustments stipulated in the Repurchase Agreement.

The options lapsed on December 31, 2004. As such, although the consideration was paid in full in 2003, the acquisition date for accounting purpose is December 31, 2004.

During the year, the Company acquired from British Gas International Limited a 20.767% interest in the Muturi Production Sharing Contract ("Muturi PSC") for a consideration of US\$105.1 million (equivalent to approximately RMB869,881,000), subject to a final price adjustment. The purchase increased the Company's interest in the Muturi PSC to 64.767% and its interest in the Tangguh LNG Project increased from 12.5% to 16.96%. The Company completed the acquisition on May 13, 2004. As at December 31, 2004, Tangguh LNG project was still in the development stage.

- (ii) On May 15, 2003, the Company entered into an equity sale and purchase agreement and a Gas Production and Processing Agreement (the "Agreements") with the existing North West Shelf ("NWS Project") partners to acquire an interest in the upstream production and reserves of the NWS Project. Under the Agreement, the Company will acquire an interest of approximately 5.3% in the NWS Project and a 25% interest in the China LNG Joint Venture, a new joint venture to be established within the NWS Project. According to the Agreement, the Company has the right to acquire more interest in the NWS Project should the final quantity of LNG committed under the LNG supply agreement to the facilities in Guangdong Province be increased. The total consideration of the acquisition is US\$348 million, subject to certain conditions, including the LNG supply agreement to Guangdong becoming unconditional, have been fulfilled. In addition, the Company will be required to make an upfront tariff payment relating to certain LNG processing facilities amounting to

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US\$180 million. CNOOC has an equity interest in the Guangdong LNG Project.

On December 23, 2003, the Company signed a Deed of Amendment to the Agreement and a Deed of Amendment to the Gas Production and Processing Agreements (the "Deeds") and agreed to pay US\$483,577,000 representing deposit of the consideration and tariff payment, to the NWS project participants by January 2, 2004. The Company made the payment on January 2, 2004.

F-22

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 4. ACQUISITIONS (CONT'D)

On December 18, 2004, the Company paid the balance of the consideration payable and concurrently entered into a side letter for the fulfillment of a condition precedent to the purchase. As such, the consideration paid of approximately US\$567 million (equivalent to approximately RMB4,693,809,000) including the payment of the tariff of US\$180 million plus direct incremental costs relating to the acquisition were included as a prepayment in property, plant and equipment as at December 31, 2004. As at December 31, 2004, NWS Project was still in the development stage.

(iii) Apart from the acquisitions above, during the year, the Company also acquired from VANCO Energy Company an 11.25% interest in a petroleum agreement in Ras Tafelney, Morocco for approximately US\$7.75 million. The PSC was still in an exploration stage as of December 31, 2004.

(iv) In addition, the Company also entered into production sharing contracts with Golden Aaron Pte. Ltd. and China Global Construction Limited in Myanmar during the year. The PSCs were still in a pre-exploration stage as of December 31, 2004. The Company is the operator.

#### 5. PRODUCTION SHARING CONTRACTS

PRC  
---

For production sharing contracts in the PRC, the foreign parties to the contracts ("foreign partners") are normally required to bear all exploration costs during the exploration period and such exploration costs can be recovered according to the production sharing formula after commercial discoveries are made and production begins.

After the initial exploration stage, the development and operating costs are funded by the Group and the foreign partners according to their respective participating interest.

In general, the Group has the option to take a up to 51% participating interest in a production sharing contract and may exercise such option after the foreign partners have independently undertaken all the exploration risks and costs and made viable commercial discoveries.



After the Group exercises its option to take a participating interest in a production sharing contract, the Group accounts for the oil and gas properties using the "proportional method" under which the Group recognises its share of development costs, revenues and expenses from such operations based on its participating interest in the production sharing contract. The Group does not account for either the exploration costs incurred by its foreign partners or the foreign partners' share of development costs and revenues and expenses from such operations.

F-23

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

5. PRODUCTION SHARING CONTRACTS (CONT'D)

PRC (cont'd)

-----

Part of the Group's annual gross production of oil and gas in the PRC is distributed to the PRC government as settlement of royalties which are payable pursuant to a sliding scale. The Group and the foreign partners also pay a production tax to the tax bureau at a pre-determined rate. In addition, there is a pre-agreed portion of oil and gas designated to recover all exploration costs, development costs, operating costs incurred and related interest according to the participating interests between the Group and the foreign partners. Any remaining oil after the foregoing priority allocations is first distributed to the PRC government as government share oil on a pre-determined ratio pursuant to a sliding scale, and then distributed to the Group and the foreign partners based on their respective participating interests. As the government share is not included in the Group's interest in the annual production, the net sales of the Group do not include the sales revenue of the government share oil.

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

Overseas

-----

The Group and the other partners to the production sharing contracts in Indonesia are required to bear all exploration, development and operating costs according to their respective participating interests. Exploration, development and operating costs which qualify for recovery can be recovered according to the production sharing formula after commercial discoveries are made and production begins.

The Group's net interest in the production sharing contracts in Indonesia consists of its participating interest in the properties covered under the relevant production sharing contracts, less oil and gas distributed to the Indonesian government and the domestic market obligation.

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### 6. SEGMENT INFORMATION

The Group is organised on a worldwide basis into three major operating segments. Segment information is presented by way of two segment formats: (i) on a primary reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

Intersegment transactions: segment revenue, segment expenses and segment performance include transfers between business segments and between geographical segments. Such transfers are accounted for at cost. Those transfers are eliminated on consolidation.

#### (a) Business segments

The Group is involved in the upstream operating activities of the petroleum industry that comprise independent operations, production sharing contracts with foreign partners and trading business. These segments are determined primarily because the senior management makes key operating decisions and assesses performance of the segments separately. The Group evaluates performance based on profit or loss from operations before income taxes.

F-24

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 6. SEGMENT INFORMATION (CONT'D)

#### (a) Business segments (cont'd)

The following tables present revenues, profit and certain assets, liabilities and expenditures information for the Group's business segments.

Segment revenue -----	Independent operations			Pro
	2002	2003	2004	20
	RMB'000	RMB'000	RMB'000	RMB'0
Sales to external customers:				
Oil and gas sales	10,318,549	12,040,587	15,177,621	13,460,74
Marketing revenues	-	-	-	
Intersegment revenues	-	-	920,669	1,023,54
Other income	43,513	8,468	6,139	133,10
Total	10,362,062	12,049,055	16,104,429	14,617,40
Segment results -----				
Operating expenses	(1,268,360)	(1,579,004)	(1,828,614)	(2,506,97

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Production taxes	( 556,583)	( 626,897)	(775,210)	( 466,46)
Exploration costs	(1,241,759)	(590,541)	(1,136,055)	(76,56)
Depreciation, depletion and amortisation	(1,635,131)	(1,855,983)	(2,235,064)	(2,384,40)
Dismantlement	( 72,751)	( 96,206)	(117,310)	( 53,38)
Crude oil and product purchases	-	-	(920,669)	(1,023,54)
Selling and administrative expenses	(38,548)	(62,247)	(50,721)	(553,53)
Others	-	(36,406)	-	(30,86)
Interest income	-	-	-	3,83
Interest expenses	(62,081)	(60,358)	(135,119)	(17,10)
Exchange gains/(losses), net	-	-	-	79
Short term investments income	-	-	-	-
Share of profit of associates	-	-	-	-
Non-operating income/(expenses), net	(85,414)	-	-	(22)
Tax	-	-	-	-
<b>Net profit</b>	<b>5,401,435</b>	<b>7,141,413</b>	<b>8,905,667</b>	<b>7,508,96</b>
Other segment information				
Segment assets	16,899,455	36,087,581	20,670,651	22,446,44
Investment in associates	-	-	-	-
Total assets	16,899,455	36,087,581	20,670,651	22,446,44
Segment liabilities	(3,033,327)	(3,554,720)	(3,913,905)	(10,200,03)
Capital expenditure	2,770,640	5,960,071	6,309,397	4,396,93
Trading business				
Segment revenue	2002	2003	2004	2005
	RMB '000	RMB '000	RMB '000	RMB '000
Sales to external customers:				
Oil and gas sales	-	-	-	-
Marketing revenues	2,377,469	12,398,661	18,191,353	-
Intersegment revenues	-	-	-	-
Other income	-	-	-	40,4
Total	2,377,469	12,398,661	18,191,353	40,4
Segment results				
Operating expenses	-	-	-	-
Production taxes	-	-	-	-
Exploration costs	-	-	-	-
Depreciation, depletion and amortisation	-	-	-	-
Dismantlement	-	-	-	-
Crude oil and product purchases	(2,326,338)	(12,295,238)	(17,963,461)	-
Selling and administrative expenses	-	-	-	(414,4
Others	-	-	-	-
Interest income	-	-	-	144,0
Interest expenses	-	-	-	(215,6
Exchange gains/(losses), net	-	-	-	(114,6
Short term investments income	-	-	-	193,2
Share of profit of associates	-	-	-	165,3
Non-operating income/(expenses), net	-	-	-	14,2
Tax	-	-	-	(3,541,4
<b>Net profit</b>	<b>51,131</b>	<b>103,423</b>	<b>227,892</b>	<b>(3,728,7</b>

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Other segment information				
Segment assets	630,704	2,629,009	1,712,212	20,581,7
Investment in associates	-	-	-	537,3
Total assets	630,704	2,629,009	1,712,212	21,119,0
Segment liabilities	(21,665)	(2,173,828)	(809,663)	(7,272,1
Capital expenditure	-	-	-	37,6

Segment revenue	Eliminations			
	2002	2003	2004	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Sales to external customers:				
Oil and gas sales	-	-	-	23,779,2
Marketing revenues	-	-	-	2,377,4
Intersegment revenues	(1,023,547)	(3,730,797)	(3,471,850)	
Other income	-	-	-	217,0
Total	(1,023,547)	(3,730,797)	(3,471,850)	26,373,8
Segment results				
Operating expenses	-	-	-	(3,775,3
Production taxes	-	-	-	(1,023,0
Exploration costs	-	-	-	(1,318,3
Depreciation, depletion and amortisation	-	-	-	(4,019,5
Dismantlement	-	-	-	( 126,1
Crude oil and product purchases	1,023,547	3,730,797	3,471,850	(2,326,3
Selling and administrative expenses	-	-	-	(1,006,5
Others	-	-	-	(30,8
Interest income	-	-	-	147,8
Interest expenses	-	-	-	(294,7
Exchange gains/(losses), net	-	-	-	(113,8
Short term investments income	-	-	-	193,2
Share of profit of associates	-	-	-	165,3
Non-operating income/(expenses), net	-	-	-	(71,3
Tax	-	-	-	(3,541,4
Net profit				9,232,8
Other segment information				
Segment assets	-	-	-	60,558,3
Investment in associates	-	-	-	537,3
Total assets	-	-	-	61,095,7
Segment liabilities	-	-	-	(20,527,2
Capital expenditure	-	-	-	7,205,2

F-25

CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

6. SEGMENT INFORMATION (CONT'D)

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(b) Geographical segments

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the Group's customers, and assets are attributed to the segments based on the location of the Group's assets.

The Group mainly engaged in the exploration, development and production of crude oil and natural gas in offshore China. Any activities outside PRC are mainly conducted in Indonesia and Singapore. An analysis by geographical segment is as follows:

	PRC			
	2002	2003	2004	
	RMB'000	RMB'000	RMB'000	RMB'000
External sales	22,781,301	25,416,466	30,453,453	3,592,514
Segment assets	50,647,452	61,357,931	75,298,171	10,448,253
Capital expenditures	6,453,798	7,727,171	12,014,894	751,427
	Total			
	2002	2003	2004	
External sales	26,373,815	40,950,273	55,222,063	
Segment assets	61,095,705	73,504,302	94,076,531	
Capital expenditures	7,205,225	8,271,564	19,620,011	

(c) An analysis of sales to major customers by business segment is as follows:

	2002	2003
	RMB'000	RMB'000
Production sharing contracts		
-----		
China Petroleum & Chemical Corporation	3,707,536	3,848,361
PetroChina Company Limited	1,187,571	1,446,169
Castle Peak Power Company Limited	1,247,639	841,285
	6,142,746	6,135,815
Independent operations		
-----		
China Petroleum & Chemical Corporation	3,183,341	3,126,708
	9,326,087	9,262,523

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7. OIL AND GAS SALES

	2002	2003
	-----	-----
	RMB'000	RMB'000
Gross sales	26,086,646	30,556,967
Royalties	( 464,113)	( 478,454)
PRC government share oil	( 1,843,239)	( 1,961,682)
	-----	-----
	23,779,294	28,116,831
	=====	=====

F-26

CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

8. MARKETING PROFIT

	2002	2003
	-----	-----
	RMB'000	RMB'000
Marketing revenues	2,377,469	12,398,661
Crude oil and product purchases	( 2,326,338)	(12,295,238)
	-----	-----
	51,131	103,423
	=====	=====

9. SELLING AND ADMINISTRATIVE EXPENSES

	2002	2003
	-----	-----
	RMB'000	RMB'000
Salary and staff benefits	390,376	393,165
Utility and office expenses	100,502	90,801
Transportation and entertainment	64,319	74,218
Rentals and maintenance	75,738	107,310

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Management fee	151,860	219,771
Selling expenses	38,548	30,686
(Reversal) of/Provision for inventory obsolescence	-	8,745
Other	185,197	287,827
	-----	-----
	1,006,540	1,212,523
	=====	=====

10. INTEREST EXPENSES

	2002	2003
	-----	-----
	RMB'000	RMB'000
Interest on bank loans which are:		
- wholly repayable within five years	177,156	81,539
- not wholly repayable within five years	-	-
Interest on long term guaranteed notes	215,028	391,005
Other borrowing costs	12,426	34,933
	-----	-----
Total interest	404,610	507,477
Less: Amount capitalised in property, plant and equipment (note 16)	( 187,714)	( 245,783)
	-----	-----
	216,896	261,694
Other finance costs:		
Increase in discounted amount of provisions arising from the passage of time (note 27)	77,896	93,246
	-----	-----
	294,792	354,940
	=====	=====

The interest rates used for interest capitalisation represented the cost of capital from raising the related borrowings and varied from 4.1% to 9.2% per annum for the year ended December 31, 2004. (2003:4.1% to 9.15%, 2002:2.35% to 9.15%).

F-27

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

11. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, is as follows:

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	2002	2003
	-----	-----
	RMB'000	RMB'000
Fees for executive directors	-	-
Fees for non-executive directors	890	1,000
Other emoluments for executive directors		
- Basic salaries and allowances	6,654	6,327
- Bonus	1,109	2,100
- Pension scheme contribution	214	207
- Other	1,500	1,425

The number of directors whose remuneration fell within the following bands is as follows:

	Number of Directors	
	2002	2003
	-----	-----
Nil to HK\$1,000,000	8	6
HK\$1,000,001- HK\$1,500,000	-	1
HK\$1,500,001- HK\$2,000,000	2	-
HK\$2,000,001- HK\$2,500,000	1	-
HK\$2,500,001- HK\$3,000,000	-	2
HK\$3,000,001- HK\$3,500,000	-	-
	-----	-----
	11	9
	=====	=====

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

No value in respect of the share options granted during the year (note 28) has been charged to the income statement, or is otherwise included in the above directors' remuneration disclosures.

F-28

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

12. FIVE HIGHEST PAID EMPLOYEES



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Details of the remuneration of the five highest paid employees during the year are as follows:

	2002	2003
	RMB'000	RMB'000
Basic salaries and allowances	8,227	15,857
Bonus	2,518	2,550
Pension scheme contributions	505	1,332
Other	2,732	2,743
	-----	-----
	13,982	22,482
	=====	=====
Number of directors	4	-
Number of employees	1	5

The number of highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2002	2003
Nil to HK\$1,000,000	1	-
HK\$1,500,001- HK\$2,000,000	2	-
HK\$2,500,001- HK\$3,000,000	1	-
HK\$3,000,001- HK\$3,500,000	-	-
HK\$3,500,001- HK\$4,000,000	-	3
HK\$4,000,001- HK\$4,500,000	-	-
HK\$4,500,001- HK\$5,000,000	1	-
HK\$5,000,001- HK\$5,500,000	-	2
HK\$5,500,001- HK\$6,000,000	-	-
HK\$6,000,001- HK\$8,000,000	-	-
HK\$8,000,001- HK\$8,500,000	-	-
	-----	-----
	5	5
	=====	=====

No value in respect of the share options granted during the year (note 28) has been charged to the income statement, or is otherwise included in the above five highest paid employees disclosures.

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### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 13. TAX

##### (i) Income tax

The Company and its subsidiaries are subject to income taxes on an entity basis on profit arising in or derived from the tax jurisdictions in which they are domiciled and operated. The Company is not liable for profits tax in Hong Kong as it does not have any assessable income currently sourced from Hong Kong.

The Company's subsidiary, CNOOC China Limited, is a wholly foreign-owned enterprise established in the PRC. It is exempt from the 3% local surcharge and is subject to an enterprise income tax of 30% under the prevailing tax rules and regulations.

The Company's subsidiary in Singapore, China Offshore Oil (Singapore) International Pte Ltd., is subject to income tax at rates of 10% and 20%, for its oil trading activities and other income generating activities, respectively. The Company's subsidiaries owning interests in oil and gas properties in Indonesia along the Malacca Strait are subject to corporate and dividend tax at the rate of 44%. The Company's subsidiaries owning interests in oil and gas properties in Indonesia acquired from Repsol YPF, S.A. are subject to corporate and dividend tax at the rate of 43.125% to 51.875%. All of the Company's other subsidiaries are not subject to any income taxes in their respective jurisdictions for the year presented.

An analysis of the provision for tax in the consolidated income statement was as follows:

	2002	2003
	RMB'000	RMB'000
Overseas income taxes		
- Current	406,493	654,988
- Deferred	26,094	(179,134)
PRC enterprise income tax		
- Current	2,786,938	3,623,157
- Deferred	321,891	528,825
	-----	-----
Tax charge for the year	3,541,416	4,627,836
	=====	=====

A reconciliation of the statutory PRC enterprise income tax rate to the effective income tax rate of the Group is as follows:

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	2002	2003
	----- %	----- %
Statutory PRC enterprise income tax rate	33.0	33.0
Effect of tax exemption granted	(3.0)	(3.0)
Effect of different tax rates for overseas subsidiaries	0.2	(0.1)
Tax credit from government	(2.1)	(1.5)
Tax effect on other permanent differences	(0.4)	0.2
	-----	-----
Effective income tax rate	27.7	28.6
	=====	=====

F-30

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

13. TAX (CONT'D)

(i) Income tax (cont'd)

The tax effect of significant temporary differences of the Group was as follows:

	2002	2003
	----- RMB'000	----- RMB'000
Deferred tax assets		
- Provision for retirement and termination benefits	86,602	114,775
- Provision for dismantlement	671,796	775,775
- Provision for impairment of property, plant and equipment and write-off of unsuccessful exploratory drillings	933,636	759,775
	-----	-----
	1,692,034	1,649,775
	-----	-----
Deferred tax liabilities		
- Accelerated amortisation allowance for oil and gas properties	(7,833,190)	(7,433,190)
	-----	-----
Net deferred tax liabilities	(6,141,156)	(5,783,190)
	=====	=====

As at December 31, 2004, there was no significant unrecognised

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deferred tax liability (2003: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and associates as the Group had no liability to additional tax should such amounts be remitted.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

### (ii) Other taxes

The Company's PRC subsidiary pays the following other taxes:

- Production taxes equal to 5% of independent production and production under production sharing contracts; and
- Business tax of 3% to 5% on other income.

### 14. DIVIDENDS

On April 28, 2004, the board of directors declared an interim dividend and a special interim dividend of HK\$0.06 per share in place of 2003 final dividend and final special dividend, totaling HK\$2,464,249,697 (equivalent to approximately RMB2,617,526,000) (2003: nil). The board of directors also withdrew its recommendation that the Company declare any final or special final dividend for the year ended December 31, 2003.

On August 25, 2004, the board of directors declared an interim dividend of HK\$0.03 per share (2003: HK\$0.028 per share), totaling HK\$1,231,618,058 (equivalent to approximately RMB1,306,451,000) (2003: RMB1,220,132,000), and a special interim dividend of HK\$0.05 per share (2003: HK\$0.036 per share), totaling HK\$2,052,696,764 (equivalent to approximately RMB2,177,418,000) (2003: RMB1,568,741,000).

F-31

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 14. DIVIDENDS (CONT'D)

The board of directors have recommended a final dividend of HK\$0.03 per ordinary share, totaling HK\$1,231,571,258 (approximately equivalent to RMB1,310,022,000), and a special final dividend of HK\$0.05 per ordinary share, totaling HK\$2,052,618,764 (approximately equivalent to RMB2,183,371,000) for the year ended December 31, 2004.

The payment of future dividends will be determined by the Company's board of directors. The payment of dividends will depend upon, among other things, future earnings, capital requirements, financial conditions and general business conditions of the Company. The Company's ability to pay dividends will also depend on the cash flows determined by the dividends, if any, received by the Company from its subsidiaries and associated companies. As the controlling shareholder, CNOOC will be able to influence the Company's dividend policy.

Cash dividends to the shareholders in Hong Kong will be paid in Hong Kong dollars and dividends to the American Depositary Receipts ("ADR") holders

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will be paid to the depositary in Hong Kong dollars and will be converted by the depositary into United States dollars and paid to the holders of ADRs.

15. EARNINGS PER SHARE

	2002	2003
	RMB'000	RMB'000
Earnings		
-----		
Net profit attributable to shareholders, used in the basic and diluted earnings per share calculations	9,232,827	11,535,490
Shares (after Stock Split)		Number of shares
-----		
	2002	2003
Weighted average number of ordinary shares for the purpose or basic earnings before effects of shares repurchased	41,070,828,275	41,070,828,275
Effects of shares repurchased	-	-
Weighted average number of ordinary shares for the purpose of basic earnings per share	41,070,828,275	41,070,828,275
Effect of dilutive potential ordinary shares under shares option scheme	25,598,645	39,510,820
Effect of diluted potential ordinary shares for convertible bonds	-	-
Weighted average number of ordinary shares for the purpose of diluted earnings per share	41,096,426,920	41,110,339,095
	=====	=====

Net income per ADS for the three years ended December 31, 2004 has been computed by dividing net income by the number of ADS outstanding. Each ADS represented 100 shares.

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## NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 16. PROPERTY, PLANT AND EQUIPMENT, NET

Movements in the property, plant and equipment of the Group are as follows:

	2004		
	Oil and gas properties RMB'000	Land and buildings RMB'000	Vehicles and office equipment RMB'000
Cost or valuation:			
At beginning of year	70,137,828	824,781	139,902
Additions	12,845,367	116,797	47,977
Acquisition (including prepayments)	6,934,951	-	-
Disposals and write-off	( 3)	-	( 174)
Exchange realignment	( 249)	-	-
	89,917,894	941,578	187,705
Analysis of cost or valuation			
At cost	89,917,894	116,797	187,705
At revaluation	-	824,781	-
	89,917,894	941,578	187,705
Accumulated depreciation, depletion and amortisation:			
At beginning of year	( 27,839,105)	( 106,401)	(33,204)
Depreciation provided during the year	( 5,575,114)	( 26,054)	(10,882)
Disposals	-	-	5
Exchange realignment	83	-	192
	(33,414,136)	(132,455)	(43,889)
Net book value:			
Beginning of year	42,298,723	718,380	106,698
	56,503,758	809,123	143,816
Had the property, plant and equipment been carried at cost less accumulated depreciation, depletion and amortisation, the carrying amount of each class would have been:			

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Cost	89,917,894	666,907	187,705
Accumulated depreciation, depletion and amortisation	(33,414,136)	(88,246)	(43,889)
	=====	=====	=====
	56,503,758	578,661	143,816
	=====	=====	=====

F-33

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

16. PROPERTY, PLANT AND EQUIPMENT, NET (CONT'D)

	2003		
	Oil and gas properties	Land and buildings	Vehicles and office equipment
	RMB'000	RMB'000	RMB'000
Cost or valuation:			
At beginning of year	58,321,780	824,781	93,720
Purchase price allocation adjustment	( 707,623)	-	-
Additions	8,538,930	-	46,868
Acquisition (including prepayments)	4,025,441	-	-
Disposals and write-off	( 39,798)	-	( 604)
Exchange realignment	( 902)	-	( 82)
	=====	=====	=====
End of year	70,137,828	824,781	139,902
	=====	=====	=====
Analysis of cost or valuation			
At cost	70,137,828	-	139,902
At revaluation	-	824,781	-
	=====	=====	=====
	70,137,828	824,781	139,902
	=====	=====	=====
Accumulated depreciation, depletion and amortisation:			
At beginning of year	(23,059,600)	( 81,027)	(27,834)
Depreciation provided during the year	( 4,779,271)	( 25,374)	( 6,045)
Disposals	-	-	584
Exchange realignment	( 234)	-	91
	=====	=====	=====
End of year	(27,839,105)	(106,401)	(33,204)
	=====	=====	=====

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Net book value:			
Beginning of year	35,262,180	743,754	65,886
	=====	=====	=====
End of year	42,298,723	718,380	106,698
	=====	=====	=====
Had the property, plant and equipment been carried at cost less accumulated depreciation, depletion and amortisation, the carrying amount of each class would have been:			
Cost	70,137,828	550,110	139,902
Accumulated depreciation, depletion and amortisation	(27,839,105)	( 71,348)	(33,204)
	-----	-----	-----
	42,298,723	478,762	106,698
	=====	=====	=====

F-34

CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

16. PROPERTY, PLANT AND EQUIPMENT, NET (CONT'D)

During the year, additions to the Group's property, plant and equipment amounted to approximately RMB13,010,141,000 (2003: RMB8,585,798,000). The consideration paid of US\$567 million (equivalent to RMB4,693,809,000) for the NWS project (see note 4(ii)) has been included as a prepayment in oil and gas properties as at December 31, 2004.

Included in the current year additions was an amount of approximately RMB244,686,000 (2003: RMB245,783,000) in respect of interest capitalised in property, plant and equipment.

The land and buildings of the Group are held outside Hong Kong with lease terms of 50 years.

The land and buildings were revalued by an independent valuer, Sallmanns (Far East) Limited, Chartered Surveyors (the "Valuer") as at December 31, 2000 using a depreciated replacement cost approach. The depreciated replacement cost approach considers the cost to reproduce or replace in new condition the property being appraised in accordance with current construction costs for similar property in the locality with allowance for accrued depreciation as evidenced by observed condition or obsolescence present, whether arising from physical, functional or economic causes. The Valuer assumed that the assets would be used for the purposes for which they are presently used and did not consider alternative uses. Certain land use rights which were previously granted by the PRC government at no cost.

17. INVESTMENTS IN ASSOCIATES



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Investments in associates represent (1) a 30% equity interest of CNOOC China Limited in Shanghai Petroleum and Natural Gas Company Limited ("SPC"). SPC was incorporated on September 7, 1992 in the PRC with limited liability and is principally engaged in offshore petroleum exploration, development, production and sale in the South Yellow Sea and East China Sea areas. The issued and paid-up capital of SPC is RMB900 million; and (2) a 31.8% equity interest of CNOOC China Limited in CNOOC Finance Corporation Limited ("CNOOC Finance"). CNOOC Finance was incorporated on May 13, 2002 in the PRC with limited liability and is principally engaged in deposit-taking and money lending activities for the CNOOC Group. The issued and paid-up capital of CNOOC Finance is RMB1,415 million.

	2003	2004
	-----	-----
	RMB'000	RMB' 000
Share of net assets	1,117,640	1,327,109
	=====	=====

The directors are of the opinion that the underlying value of the investments in associates is not less than the carrying amount of the associates as at December 31, 2004 and 2003.

F-35

CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

18. ACCOUNTS RECEIVABLE, NET

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The customers are required to make payment within 30 days after the delivery of oil and gas. As at December 31, 2004 and 2003, substantially all the accounts receivable were aged within six months.

19. INVENTORIES AND SUPPLIES

	2003
	-----
	RMB'000
Materials and supplies	809,827
Oil in tanks	291,844
Less: Provision for inventories obsolescence	( 8,745)
	-----
	1,092,926
	=====

20. SHORT TERM INVESTMENTS

As at December 31, 2004 and 2003, short term investments mainly represented investments in liquidity funds and were stated at fair value at the balance sheet date. Details of the short term investments were as follows:

	2003
	-----
	RMB'000
Unlisted investments, at fair value	
Liquidity funds	3,767,179
Corporate bonds	1,876,880
Common stock	40,274
	-----
	5,684,333
	=====

21. ACCOUNTS PAYABLE

As at December 31, 2004 and 2003, substantially all the accounts payable were aged within six months.

F-36

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

22. OTHER PAYABLES AND ACCRUED LIABILITIES

	2003
	-----
	RMB'000
Accrued payroll and welfare payable	149,532
Provision for retirement and termination benefits	290,955
Accrued expenses	926,867
Advances from customers	10,864
Royalties payable	205,113
Other payables	372,452
	-----

1,955,783  
=====

As at December 31, 2004, deferred revenue from gas sales contracts amounted to approximately RMB1,050,000 (2003: RMB1,208,000) and was included in other payables.

23. LONG TERM BANK LOANS

As at December 31, 2004, the long term bank loans of the Group were used primarily to finance the development of oil and gas properties and to meet working capital requirements.

	Interest rate and final maturity	2003
	-----	-----
		RMB'000
US\$ denominated bank loans	Fixed interest rate of 9.2% per annum with maturities through 2006	827,615
Japanese Yen denominated bank loans	Fixed interest rate of 4.1% per annum with maturities through to 2007	82,578
		-----
		910,193
Less: Current portion of long term bank loans		( 20,618)
		-----
		889,575
		=====

As at December 31, 2004 and 2003, all the bank loans of the Group were unsecured and none of the outstanding borrowings were guaranteed by CNOOC.

F-37

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

23. LONG TERM BANK LOANS (CONT'D)

The maturities of the long term bank loans are as follows:

2003  
-----

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	RMB'000
Balances due:	
- Within one year	20,618
- After one year but within two years	24,364
- After two years but within three years	846,471
- After three years but within four years	18,740
- After four years but within five years	-
	-----
	910,193
Amount due within one year shown under current liabilities	( 20,618)
	-----
	889,575
	=====

Supplemental information with respect to long term bank loans:

For the year ended December 31	Balance at year end RMB'000	Weighted average interest rate at year end	Maximum amount outstanding during the year RMB'000	A outst duri R
-----	-----	-----	-----	-----
2004	889,575	8.81%	910,193	8
2003	910,193	8.69%	1,238,611	1,0

\* The average amount outstanding is computed by dividing the total of outstanding principal balances as at January 1 and December 31 by two.

\*\* The weighted average interest rate is computed by dividing the total of weighted average interest rates as at January 1 and December 31 by two.

F-38

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

24. LONG TERM GUARANTEED NOTES

On March 1, 2002, CNOOC Finance (2002) Limited, a company incorporated in the British Virgin Islands on January 24, 2002 and a wholly-owned subsidiary of the Company, issued US\$500 million of a principal amount of 6.375% guaranteed notes due in 2012. The obligations of CNOOC Finance (2002) Limited in respect of the notes are unconditionally and

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irrevocably guaranteed by the Company.

On May 21, 2003, CNOOC Finance (2003) Limited, a company incorporated in the British Virgin Islands on April 2, 2003 and a wholly-owned subsidiary of the Company, issued US\$200 million of a principal amount of 4.125% guaranteed notes due in 2013 and US\$300 million of a principal amount of 5.500% guaranteed notes due in 2033. The obligations of CNOOC Finance (2003) Limited in respect of the notes are unconditionally and irrevocably guaranteed by the Company.

On December 15, 2004, CNOOC Finance (2004) Limited, a company incorporated in the British Virgin Islands on December 9, 2004 and a wholly-owned subsidiary of the Company, issued US\$1 billion zero coupon guaranteed convertible bonds due 2009, unconditionally and irrevocably guaranteed by, and convertible into shares of the Company. The bonds are converted at HK\$6.075 per share, subject to adjustment for, among other things, subdivision or consolidation of shares, bond issues, right issues, capital distribution and other dilutive events. Unless previously redeemed, converted or purchased and cancelled, the bonds will be redeemed on the maturity date at 105.114% of the principal amount.

### 25. BALANCES WITH THE PARENT COMPANY

As at December 31, 2004 and 2003, the balances with CNOOC were unsecured, interest-free and were repayable on demand.

### 26. RELATED PARTY TRANSACTIONS

Companies are considered to be related if one Company has the ability, directly or indirectly, to control the other Company or exercise significant influence over the other Company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence.

The Group has entered into several agreements with CNOOC and its affiliates, which govern the provision of materials, utilities and ancillary services, the provision of technical services, the provision of research and development services, and various other commercial arrangements.

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year:

F-39

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 26. RELATED PARTY TRANSACTIONS (CONT'D)

Notes	2002	2003
-------	------	------

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		----- RMB'000	----- RMB'000
Materials, utilities and ancillary services	(i)	789,167	1,018,066
Technical services	(ii)	3,279,596	3,828,282
Research and development services	(iii)	167,354	83,280
Lease and property management services	(iv)	54,421	56,867
Included in:			
Exploration expenses		593,059	487,293
Operating expenses		993,825	1,176,601
Selling and administrative expenses		190,449	191,349
Capitalised under property, plant and equipment		2,513,205	3,131,252

(i) Materials, utilities and ancillary services

CNOOC China Limited has entered into materials, utilities and ancillary services supply agreements with the affiliates of CNOOC. Under these agreements, the affiliates of CNOOC provide to CNOOC China Limited various materials, utilities and ancillary services.

The materials, utilities and ancillary services are provided at:

- state-prescribed prices; or
- where there is no state-prescribed price, at market prices, including the local or national market prices or the prices at which CNOOC's affiliates previously provided the relevant materials, utilities and ancillary services to independent third parties; or
- where neither of the prices mentioned above is applicable, at the cost to CNOOC's affiliates of providing the relevant materials, utilities and services, including the cost of sourcing or purchasing from third parties, plus a margin of not more than 5% before any applicable taxes.

(ii) Technical services

CNOOC China Limited has entered into technical service agreements with certain affiliates of CNOOC. According to the agreements, the Group uses the technical services including:

- offshore drilling;
- ship tugging, oil tanker transportation and security services;
- well survey, well logging, well cementation and other related technical services;
- collection of geophysical data, ocean geological prospecting, and data processing;
- platform fabrication service and maintenance; and
- design, construction, installation and test of offshore and onshore production facilities.

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

26. RELATED PARTY TRANSACTIONS (CONT'D)

(iii) Research and development services

The Group has revised the original research and development services agreement with CNOOC's subsidiary, China Offshore Oil Research Centre, due to the restructuring of operations in 2004.

(iv) Lease and property management services

The Group has entered into lease and property management services agreements with the affiliates of CNOOC for the leasing of various office, warehouse and residential premises. Lease charges are based on the prevailing market rates.

(v) Sale of crude oil, condensated oil and liquefied petroleum gas

The Group sells crude oil, condensated oil and liquefied petroleum gas to CNOOC's affiliates which engage in the downstream petroleum business at the international market price. For the year ended December 31, 2004, the total sales amounted to approximately RMB13,945,565,000 (2003: RMB8,324,108,000).

During the period, the Company, through its wholly-owned subsidiary, China Offshore Oil (Singapore) International Pte., Ltd. imported oil into the PRC for trading, using CNOOC's import license. For the year ended December 31, 2004, the total sales to its customers through such arrangements amounted to approximately RMB446,923,000 (2003: RMB1,470,832,000). The commission paid by the third party customers to CNOOC for the year amounted to approximately RMB2,682,000 (2003: RMB8,825,000).

(vi) Deposits with CNOOC Finance Corporation Limited

The Company entered into a framework agreement with CNOOC Finance Corporation Limited ("CNOOC Finance") on April 8, 2004. Under the framework agreement, the Group utilises the financial services provided by CNOOC Finance, a 31.8% owned associate company of the Company that is also a subsidiary of CNOOC. Such services include placing of the Group's cash deposits with CNOOC Finance, and settlement services for transactions between the Group and other entities including CNOOC and its subsidiaries. The charges by CNOOC Finance for its financial services to the Group are comparable to those charged by PRC banks for similar services.

For the year ended December 31, 2004, the maximum outstanding balance for deposits (including interest received in respect of these deposits) placed with CNOOC Finance amounted to approximately RMB5,300,381,000.

CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

27. PROVISION FOR DISMANTLEMENT

Provision for dismantlement represents the estimated costs of dismantling offshore oil platforms and abandoning oil and gas properties. The provision for dismantlement has been classified under long term liabilities. The associated cost is capitalised and the liability is discounted and an accretion expense is recognised using the credit-adjusted risk-free interest rate in effect when the liability is initially recognised. The current year income statement charge represents the amortisation charge on the dismantlement liabilities capitalised in accordance with SSAP 28 and is included in the accumulated depreciation, depletion and amortisation in note 16.

The details of the provision for dismantlement are as follows:

	2003
	-----
	RMB'000
At beginning of year:	2,239,320
Additional during the year and capitalised in oil and gas properties	314,234
Increase in discounted amount of provisions arising from the passage of time	93,246
	-----
End of year	2,646,800
	=====

28. SHARE CAPITAL

Shares (after stock split)  
 -----

	Number of Shares
	-----
Authorised:	
Ordinary shares of HK\$0.02 each at December 31, 2004 and 2003	75,000,000,000
	=====



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	Number of Shares	Share capital HK\$'000
	-----	-----
Issued and fully paid:		
Ordinary shares of HK\$0.02 each		
As at January 1, 2004 and January 1, 2003	41,070,828,275	821,417
Repurchased and cancelled	( 18,453,000)	( 369)
	-----	-----
As at December 31, 2004	41,052,375,275	821,048
	=====	=====

The repurchase of the Company's shares during the year were effected by the directors, pursuant to the mandate from shareholders received at the last annual general meeting.

F-42

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

28. SHARE CAPITAL (CONT'D)

Share options

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The Company has adopted share option schemes which provide for the grant of options to the Company's senior management. Under these share option schemes, the remuneration committee of the Company's board of directors will from time to time propose for the board's approval, the recipient of and number of shares underlying each option. These schemes provide for the issuance of options exercisable for shares granted under these schemes as described below not exceeding 10% of the total number of the Company's outstanding shares, excluding shares issued upon exercise of options granted under the schemes from time to time.

On February 4, 2001, the Company adopted a pre-global offering share option scheme (the "Pre-Global Offering Share Option Scheme"). Pursuant to the Pre-Global Offering Share Option Scheme:

1. options for an aggregate of 23,100,000 shares have been granted;
2. the subscription price per share is HK\$1.19; and
3. the period during which an option may be exercised is as follows:
  - (a) 50% of the shares underlying the option shall vest 18 months after the date of the grant; and

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- (b) 50% of the shares underlying the option shall vest 30 months after the date of the grant.

The exercise period for options granted under the Pre-Global Offering Share Option Scheme shall end not later than 10 years from March 12, 2001.

On February 4, 2001, the Company adopted a share option scheme (the "2001 Share Option Scheme") for the purposes of recognising the contribution that certain individuals had made to the Company and attracting and retaining the best available personnel to the Company. Pursuant to the 2001 Share Option Scheme:

1. options for an aggregate of 44,100,000 shares have been granted;
2. the subscription price per share is HK\$1.232; and
3. the period during which an option may be exercised is follows:
  - (a) one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
  - (b) one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
  - (c) one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

F-43

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

28. SHARE CAPITAL (CONT'D)

Share options (cont'd)

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The exercise period for options granted under the 2001 Share Option Scheme shall end not later than 10 years from August 27, 2001.

In view of the amendments to the relevant provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") regarding the requirements of share option schemes of a Hong Kong listed company effective on September 1, 2001, no further options will be granted under the 2001 Share Option Scheme.

In June 2002, the Company adopted a new share option scheme (the "2002 Share Option Scheme").

Under the 2002 Share Option Scheme, the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares in the Company. The maximum aggregate number of shares (including those that could be subscribed for under the Pre-Global Offering Share Option Scheme and the 2001 Share Option Scheme) which may be granted

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shall not exceed 10% of the total issued share capital of the Company. The maximum number of shares which may be granted under the 2002 Share Option Scheme to any individual in any 12-month period up to the next grant of share options shall not exceed 1% of the total issued share capital of the Company from time to time.

According to the 2002 Share Option Scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. The subscription price of a share payable by a participant upon the exercise of an option will be determined by the directors at their discretion at the date of the grant, except that such price may not be set below a minimum price which is the highest of:

1. the nominal value of shares;
2. the average closing price of the shares on The Stock Exchange of Hong Kong Limited (the "HKSE") as stated in the HKSE's quotation sheets for the five trading days immediately preceding the date of the grant of the option; and
3. the closing price of the shares on the HKSE as stated in the HKSE's quotation sheet on the date of the grant of the option.

F-44

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 28. SHARE CAPITAL (CONT'D)

Share options (cont'd)

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On February 24, 2003, the board of directors approved a grant of options in respect of 42,050,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK\$2.108 per share. The market price was HK\$2.11 per share preceding the options granted. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule;

1. one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
2. one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
3. one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from February 24, 2003.

On February 5, 2004, the board of directors approved a grant of options in respect of 50,700,000 shares to the Company's senior management under

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the 2002 Share Option Scheme. The exercise price for the options is HK\$3.152 per share. The market price was HK\$3.146 per share preceding the options granted. Options granted under the 2002 Share option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

1. one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
2. one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
3. one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from February 5, 2004.

2,300,100 share options granted under the 2002 Share Option Scheme and the 2001 Share Option Scheme have been exercised since the respective dates of grant and up to the date when the board of directors approved the financial statements. The total number of options exercisable as of December 31, 2004 was 54,533,267.

F-45

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 29. RESERVES

According to the laws and regulations of the PRC and the articles of association of CNOOC China Limited, CNOOC China Limited is required to provide for certain statutory funds, namely, the general reserve fund and staff and workers' bonus and welfare funds, which are appropriated from net profit (after making good losses from previous years), but before dividend distribution. CNOOC China Limited is required to allocate at least 10% of its net profit as reported in accordance with the generally accepted accounting principles in the PRC ("PRC GAAP") to the general reserve fund until the balance of such fund has reached 50% of its registered capital. Appropriation to the staff and workers' bonus and welfare funds, which is determined at the discretion of CNOOC China Limited's directors, is expensed as incurred under Hong Kong GAAP. The general reserve fund can only be used, upon approval by the relevant authority, to offset against accumulated losses or to increase capital. The staff and workers' bonus and welfare fund can only be used for special bonuses or collective welfare of employees, and assets acquired through this fund shall not be taken as assets of CNOOC China Limited.

As at December 31, 2004, the general reserve fund appropriated amounted to RMB4,413,610,000 (2003: RMB3,050,489,000), representing approximately 29.4% (2003: 20.4%) of the total registered capital of CNOOC China Limited.

Included in retained earnings is an amount of RMB877,109,000 (2003:

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RMB577,640,000), being the retained earnings attributable to associates.

The Company's ability to distribute dividends will largely depends on the dividends it receives from its subsidiaries. The dividends distributable by the Company's subsidiaries to the Company are determined in accordance with the relevant accounting principle required by the local authorities. As of December 31, 2004, the aggregate amount of the subsidiaries' retained earnings available for distributions to the Company amounted to approximately RMB16,652,414,000.

The cumulative translation reserves and revaluation reserves are accounted for in accordance with the accounting policies adopted for foreign currency translation and the revaluation of land and buildings.

As at December 31, 2004, the distributable profits of the Company amounted to approximately RMB1,852,482,000 (2003: RMB2,573,082,000; 2002: RMB2,945,280,000).

### 30. RETIREMENT AND TERMINATION BENEFITS

All the Group's full-time employees in the PRC are covered by a government regulated pension, and are entitled to an annual pension. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated pension at rates ranging from 9% to 22% of the employees' basic salaries.

The Company is required to make contributions to a defined contribution mandatory provident fund at a rate of 5% of the basic salaries of all full-time employees in Hong Kong. The related pension costs are expensed as incurred.

F-46

## CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 30. RETIREMENT AND TERMINATION BENEFITS (CONT'D)

The Group provides retirement and termination benefits for all local employees in Indonesia in accordance with Indonesian labour law, and provides employee benefits to expatriate staff in accordance with the relevant employment contracts. The Group has adopted an accounting policy to record liabilities for the retirement and termination benefits.

The total amount of contributions and provisions made by the Group for the above mentioned retirement and termination benefits for the year ended December 31, 2004 amounted to approximately RMB30,304,000 (2003: RMB95,147,000; 2002: RMB53,392,000).

### 31. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit before tax to cash generated from operations

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	2002	2001
	-----	-----
	RMB'000	RMB'000
Profit before tax	12,774,243	16,163,300
Adjustments for:		
Interest income	( 147,870)	( 183,500)
Interest expense	294,792	354,900
Exchange losses/(gains), net	113,814	6,700
Share of profit of associates	( 165,387)	( 220,200)
Short term investments income	( 193,277)	( 123,400)
(Reversal) of/provision for inventory obsolescence	-	8,700
Depreciation, depletion and amortisation	4,019,532	4,642,700
Loss on disposals and write-off of property, plant and equipment	437,799	39,800
Dismantlement	126,139	167,300
Amortisation of discount of long term guaranteed notes	6,100	11,200
	-----	-----
Operating cash flows before movements in working capital	17,265,885	20,867,600
Increase in accounts receivable	497,959	( 1,185,300)
Increase in inventories and supplies	( 20,211)	( 129,600)
Decrease in other current assets	( 705,664)	312,500
Increase in amounts due from related companies	( 276,771)	( 302,900)
Increase/(decrease)in an amount due to the parent company	144,945	( 105,700)
Increase in accounts payable, other payables and accrued liabilities	353,452	1,448,600
Increase/(decrease) in other taxes payable	73,551	( 4,700)
(Decrease)/increase in amounts due to related companies	73,769	242,600
	-----	-----
Cash generated from operations	17,406,915	21,142,900
	=====	=====

F-47

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

31. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (CONT'D)

(b) Acquisitions

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	2002	2003
	-----	-----
	RMB'000	RMB'000
Acquisitions		
-----		
Net assets acquired:		
Property, plant and equipment, net	8,646,487	1,579,726
Accounts receivable	2,367,045	--
Other current assets	35,175	8,959
Inventories and supplies	187,619	122,777
Cash and bank balances	1,652	17,580
Accounts payable	(1,577,214)	( 8,294)
Other payables and accrued liabilities	( 952,911)	( 47,983)
Tax payable	( 70,247)	--
Deferred tax liabilities	(3,901,780)	--
	-----	-----
	4,735,826	1,672,765
Prepayment for NWS Project	--	--
Prepayment for Tangguh Project	--	2,445,715
	-----	-----
	4,735,826	4,118,480
	=====	=====
Satisfied by:		
Prepayment made in 2003	--	--
Cash paid (including cash calls for Tangguh Project)	4,735,826	4,118,480
	-----	-----
	4,735,826	4,118,480
	=====	=====

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition is as follows:

	2002	2003
	-----	-----
	RMB'000	RMB'000
Cash consideration	4,735,826	4,118,480
Cash and bank balances acquired	( 1,652)	( 17,580)
	-----	-----
Net outflow of cash and cash equivalents	4,734,174	4,100,900
	=====	=====

Further details of the acquisition of the Tangguh LNG Project and NWS Project are included in note 4 to the financial statements. The purchase price allocations for Tangguh Project are still preliminary pending for the confirmation of the tax basis of the underlying assets.

32. CONTINGENT LIABILITIES

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As of December 2004 and 2003, there were no material contingent liabilities not provided for in the financial statements.

F-48

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 33. COMMITMENTS

#### (i) Capital commitments

As at December 31, 2004, the Group and the Company had the following capital commitments, principally for the construction and purchase of property, plant and equipment:

	2003	2004
	RMB'000	RMB'000
Contracted for	2,534,468	9,568,971
Authorised, but not contracted for	17,489,791	20,331,504

As at December 31, 2004, the Group had unutilised banking facilities amounting, to approximately RMB20,662,120,000 (2003: RMB32,455,229,500).

#### (ii) Operating lease commitments

##### (a) Office properties

The Group leases certain, of its office properties under operating lease arrangements, leases properties are negotiated for terms ranging from 10 months to 3 years.

As at December 31, 2004, the Group had total minimum lease payments under non-cancelable operating leases falling due as follows:

	2003	2004
	RMB'000	RMB'000
Commitments due:	17,222	24,824
- Within one year	3,174	549
- After one year but within two years	20,396	25,373
	20,396	25,373

##### (b) Plant and equipment

During the year, the Group also entered into an operating lease arrangement for certain plant and equipment for a term of 20 years. As at December 31, 2004, the total minimum lease payments under non-cancelable operating lease attributable to the Group falling within one year were RMB149,360,000, in the second to fifth years were RMB597,442,000 and after five years



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were RMB1,834,023,000.

(iii) Commitment to invest in the Gorgon Joint Venture

In October 2003, the Company entered into an agreement with the participants in the Gorgon Joint Venture to place a significant volume of Gorgon LNG to supply the growing Chinese market. Subject to the completion of formal contracts, the Company will purchase a certain equity stake in the Gorgon gas development and its parent company, CNOOC, will arrange to purchase LNG directly from Gorgon.

F-49

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

33. COMMITMENTS (CONT'D)

(iv) Financial instruments

(a) Currency swap contracts

As at December 31, 2004, the Group had a currency swap contract with a financial institution to sell United States dollars in exchange for Japanese Yen in order to hedge against future repayments of certain Japanese Yen denominated loans. The hedged Japanese Yen loans bore interest at a fixed rate of 4.5% per annum. The interest stipulated in the swap contract for the United States dollars was the floating LIBOR rate.

The details are as follows:

	2003		
Year	Notional contract amount (JPY'000)	Weighted average contractual exchange rate (JPY/US\$)	Not con a (JPY
2004	271,470	95.00	
2005	271,470	95.00	27
2006	271,470	95.00	27
2007	271,470	95.00	27

(b) Fair value of financial instruments

The carrying value of cash and cash equivalents, time deposits and short-term investments approximated fair value due to the short maturity of these instruments.

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The estimated fair value of long term bank loans based on current market interest rates was approximately RMB967,770,000 as at December 31, 2004 (2003: RMB1,064,895,000).

The estimated fair value of long term guaranteed notes based on current market interest rates was approximately US\$1,985,009,900 as at December 31, 2004 (2003: RMB8,304,647,000).

F-50

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 34. CONCENTRATION OF RISKS

#### (a) Credit risk

The carrying amount of cash and cash equivalents, time deposits, liquidity funds and bond investments, accounts receivable and other receivables, and due from related parties and other current assets except for prepayments represents our maximum exposure to credit risk in relation to financial assets.

The majority of our accounts receivable is related to sales of oil and natural gas to third party customers. We perform ongoing credit evaluations of our customers' financial condition and generally do not require collateral on accounts receivable. We maintain a provision for doubtful accounts and actual losses have been within management's expectation.

No other financial assets carry a significant exposure to credit risk.

#### (b) Currency risk

Substantially all of our oil and gas sales are denominated in Renminbi and US dollars. In the past decade, the PRC government's policy of maintaining a stable exchange rate and China's ample foreign reserves have contributed to the stability of the Renminbi. Recently, there has been wide speculation in the international market that the Chinese government will deregulate the Renminbi exchange rate. However, the Chinese government has not determined if or when the exchange rate will be deregulated. Currently, the Renminbi exchange rate remains stable.

In the event of the deregulation in Renminbi exchange rate in the future, we may be adversely affected. At present, we are seriously conducting investigation on this issue, and will actively seek a strategy for its resolution.

As of the end of 2004, the balance of our yen-denominated loans was only 0.81 billion yen. Since we have hedged our yen loans against foreign currency swaps, we do not expect any exchange risk relating

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to Japanese yen in the future.

(c) Interest rate risk

As of the end of 2004, the interest rates for all balance of our debts were fixed. The term of the weighted average balance was approximately 9 years, with very low weighted average interest rates. The weighted average interest rates of our debts, including the newly issued convertible bonds in 2004, was only 3.6%. Therefore, if interest rates of US dollars increase in future, our debt combination can effectively avoid the risk of such increase.

(d) Business risk

The major operations are conducted in the PRC and Indonesia and accordingly are subject to special considerations and significant risks not typically associated with investments in equity securities of the United States of America and Western European companies. These include risks associated with, among others, the oil and gas industry, the political, economic and legal environments, influence of the national authorities over price setting and competition in the industry.

F-51

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

34. CONCENTRATION OF RISKS (CONT'D)

(e) Concentration of customers

A substantial portion of the oil and gas sales of the Group is made to a small number of customers on an open account basis. Details of the sales to these customers are as follows:

	2002	2003
	-----	-----
	RMB'000	RMB'000
China Petroleum & Chemical Corporation	6,890,877	6,975,069
PetroChina Company Limited	1,187,571	1,446,169
Castle Peak Power Company Limited	1,247,639	841,285

35. ADDITIONAL FINANCIAL INFORMATION

As at December 31, 2004, net current assets and total assets less current liabilities of the Group amounted to approximately RMB24,890,362,000 and RMB83,674,168,000 (2003: RMB19,956,331,000 and RMB64,197,772,000), respectively.

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As at December 31, 2004, net current assets and total assets less current liabilities of the Company amounted to approximately RMB13,635,306,000 and RMB23,490,665,000 (2003: RMB7,649,024,000 and RMB24,211,265,000), respectively.

### 36. SUBSEQUENT EVENT

The Company, through its wholly owned subsidiary has signed an agreement with a Canadian based Company, MEG Energy Corporation ("MEG"), to acquire a 16.69% stake of MEG. The Company completed the transaction and paid C\$150 million for the acquisition of 13,636,364 common shares of MEG in March 2005. MEG is principally engaged in the production of the oil sands.

### 37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP

The accounting policies adopted by the Group conform to Hong Kong GAAP, which differ in certain respects from generally accepted accounting principles in the United States of America ("US GAAP").

#### (a) Net profit and net equity

##### (i) Revaluation of land and buildings

The Group revalued certain land and buildings on August 31, 1999 and December 31, 2000 and the related revaluation surplus was recorded on the respective dates. Under Hong Kong GAAP, revaluation of property, plant and equipment is permitted and depreciation, depletion and amortisation are based on the revalued amount. Additional depreciation arising from the revaluation for the year ended December 31, 2004 was approximately RMB9,156,000 (2003: RMB9,156,000). Under US GAAP, property, plant and equipment are required to be stated at cost. Accordingly, no additional depreciation, depletion and amortisation from the revaluation are recognised under US GAAP.

F-52

## CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 37 SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

#### (a) Net profit and net equity (cont'd)

##### (ii) Short term investments

According to Hong Kong GAAP, available-for-sale investments in marketable securities are measured at fair value and related unrealised holding gains and losses are included in the current period's earnings. According to US GAAP, such investments are also measured at fair value and classified in accordance with Statement of Financial Accounting Standards ("SFAS") No.115. Under US GAAP, related unrealised gains and losses on available-for-sale securities are excluded from the current period's earnings and included in other comprehensive income.

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### (iii) Impairment of long-lived assets

Under Hong Kong GAAP, impairment charges are recognised when a long-lived asset's carrying amount exceeds the higher of an asset's net selling price and value in use, which incorporates discounting the asset's estimated future cash flows.

Under US GAAP, long-lived assets are assessed for possible impairment in accordance with SFAS No.144, "Accounting for the impairment or disposal of long-lived assets". SFAS No. 144 requires the Group to (a) recognise an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset. SFAS No. 144 requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spin-off be considered as held and used until it is disposed of.

SFAS No. 144 also requires the Group to assess the need for an impairment of capitalised costs of proved oil and gas properties and the costs of wells and related equipment and facilities on a property-by-property basis. If an impairment is indicated based on undiscounted expected future cash flows, then an impairment is recognised to the extent that net capitalised costs exceed the estimated fair value of the property. Fair value of the property is estimated by the Group using the present value of future cash flows. The impairment was determined based on the difference between the carrying value of the assets and the present value of future cash flows. It is reasonably possible that a change in reserve or price estimates could occur in the near term and adversely impact management's estimate of future cash flows and consequently the carrying value of properties.

F-53

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

### 37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

#### (a) Net profit and net equity (cont'd)

#### (iii) Impairment of long-lived assets (cont'd)

In addition, under Hong Kong GAAP, a subsequent increase in the recoverable amount of an asset is reversed to the income statement to the extent that an impairment loss on the same asset was previously recognised as an expense when the circumstances and events that led to the write-down or write-off cease to exist. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred. Under US GAAP, an impairment loss establishes a new cost basis for the impaired

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asset and the new cost basis should not be adjusted subsequently other than for further impairment losses.

For the year ended December 31, 2004, there were no impairment losses recognised under Hong Kong GAAP and US GAAP.

### (iv) Stock compensation schemes

As at December 31, 2004, the Company had three stock option schemes, which are described more fully in note 28. Prior to 2003, the Company accounted for those plans under the recognition and measurement provision of APB Opinion No.25, "Accounting for Stock Issued to Employees" and related Interpretation since certain of the options granted under those plans had an exercise price below the market value of the underlying common stock on the date of grant, stock-based employee compensation costs of RMB5,632,000 for the year ended December 31, 2002 was reflected in previously reported results. In 2003, the Company accounted for those plans under the fair value recognition provision of FASB Statement No. 123, "Accounting for Stock-Based Compensation", as amended by FASB statement No. 148, for stock-based employee compensation. Compensation costs recognised for the stock option schemes amounted to RMB46,642,000 (2003: RMB37,747,000) for the year ended December 31, 2004. All prior periods presented have been restated to reflect the compensation cost that would have been recognised had the recognition provision of Statement 123 been applied to all awards granted to employees after January 1, 1995.

The weighted average fair value of the options at the grant dates for award under the schemes was HK\$0.84 per share which was estimated using the Black-Scholes model with the following assumptions: dividend yield of 2%; and expected life of five years; expected volatility of 44%; and risk-free interest rates of 5.25%. The weighted average exercise price of the stock options was HK\$2.06 per share.

F-54

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

## 37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

### (v) Acquisition of CNOOC Finance

Under HK GAAP, the Company adopted the purchase method to account for the acquisition of 31.8% equity interest in CNOOC Finance in December 2003. Under the purchase method, the acquired results are included in the consolidated results of operations of the Company from the date of the acquisition.

As the Company and CNOOC Finance are under common control of CNOOC, under US GAAP, the acquisition is considered to be a transfer of businesses under common control and the acquired assets and liabilities are accounted at historical cost in a

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manner similar to the pooling of interests method. Accordingly, the consolidated financial statements for all periods presented have been retroactively restated as if the current structure and operations had been in existence since inception. The cash consideration paid by the Company is treated as an equity transaction in the year of the acquisition for US GAAP purpose.

(vi) Accounting for convertible debt

Under HK GAAP, prior to December 31, 2004, there were no requirements to segregate the equity and derivative components of convertible debt. As such, convertible debt was stated at amortised cost.

Under US GAAP, the derivative components will need to be bifurcated from the debt components if it contains a compound derivative or fails to fulfill certain criteria for not bifurcating. The derivative components are marked to market at each balance sheet date and the differences will be charged/credited to income. The debt components are stated at amortised cost.

F-55

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

(a) Net profit and net equity (cont'd)

(vi) Accounting for convertible debt (cont'd)

The effects on net profit and equity of the above significant differences between Hong Kong GAAP and US GAAP are summarised below:

	2002	Net Pro
	RMB'000	RM
	(Restated)	
As reported under Hong Kong GAAP	9,232,827	11,53
Impact of U.S GAAP adjustments:		
- Reversal of additional depreciation, depletion and amortisation charges arising from the revaluation surplus on land and buildings	9,156	
- Equity accounting for the results of CNOOC Finance	10,663	3
- Unrealised holding gains from available-for-sale		

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investments in marketable securities	( 36,965)	(2
- Realised holding gains from available-for-sale marketable securities	26,940	2
- Additional dismantlement based on unit-of-production method	( 197,079)	
- Impact of income tax	59,124	
- Recognition of stock compensation cost	( 19,144)	( 3
	-----	-----
Income before cumulative effect of change in accounting policy	9,085,522	11,54
Cumulative effect of change in accounting policy for dismantlement liabilities	-	43
	-----	-----
Net profit under US GAAP	9,085,522	11,97
	=====	=====
Net profit per share under US GAAP		
-Basic		
Before cumulative effect of change in accounting policy for dismantlement liabilities	RMB0.22	RM
Cumulative effect of change in accounting policy for dismantlement liabilities	-	RM
	-----	-----
	RMB0.22	RM
	=====	=====
	-----	-----
-Diluted		
Before cumulative effect of change in accounting policy for dismantlement liabilities	RMB0.22	RM
Cumulative effect of change in accounting policy for dismantlement liabilities	-	RM
	-----	-----
	RMB0.22	RM
	=====	=====

F-56

CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

(a) Net profit and net equity (cont'd)

Net Eq



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	-----	200
		-----
		RMB'00
As reported under Hong Kong GAAP		46,736,53
Impact of US GAAP adjustments:		
- Reversal of revaluation surplus on land and buildings	(	274,67
- Reversal of additional accumulated depreciation, depletion and amortisation arising from the revaluation surplus on land and buildings		35,05
- Equity accounting for the results of CNOOC Finance		41,57
- Dividend distribution made by CNOOC Finance CNOOC	(	41,57
	-----	
Net equity under US GAAP		46,496,91
	=====	

Apart from the derivative components with a total credit balance of approximately RMB450 million that are required to be bifurcated from the convertible debt, there are no other significant GAAP differences that affect classifications within the balance sheet or income statement but do not affect net income or shareholders' equity.

(b) Comprehensive income

According to SFAS No. 130, "Reporting Comprehensive Income", it is required to include a statement of other comprehensive income for revenues and expenses, gains and losses that under US GAAP are included in comprehensive income and excluded from net income.

	2002	2003
	-----	-----
	RMB'000	RMB'000
	(Restated)	
Net income under US GAAP	9,085,522	11,979,509
Other comprehensive income:		
Foreign currency translation adjustments	( 7,948)	36,243
Unrealised gains on short-term investments	36,965	21,503
Less: Reclassification adjustment for realised gains included in net income	( 26,940)	( 27,088)
	-----	-----
Comprehensive income under US GAAP	9,087,599	12,010,167
	=====	=====

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CNOOC LIMITED AND ITS SUBSIDIARIES  
 NOTES TO FINANCIAL STATEMENTS  
 (All amounts expressed in Renminbi unless otherwise stated)

37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

(b) Comprehensive income (cont'd)

Roll forward of accumulated other comprehensive income components are as follows:

	Foreign currency translation adjustments	Unrealised gains on short-term investments
	-----	-----
	RMB '000	RMB '000
Balance at January 1, 2003	(13,596)	53,821
Reversal of current year realised gains	--	(27,088)
Current year change	36,243	21,503
	-----	-----
Balance at January 1, 2004	22,647	48,236
Reversal of current year realised gains	--	( 2,972)
Current year change	(42,301)	(25,228)
	-----	-----
Balance at December 31, 2004	(19,654)	20,036
	=====	=====

The gross realised gains on sales of short-term investments totalled RMB2,972,000, RMB27,088,000 and RMB26,940,000 in 2004, 2003 and 2002, respectively. The cost of securities sold is determined based on weighted-average costing method.

(c) Derivative instruments

The Group had a currency swap contract with a financial institution to sell United States dollars in exchange for Japanese Yen in order to hedge certain Japanese Yen denominated loan repayments in the future. In accordance with SFAS No. 133 "Accounting for derivatives instruments and hedging activities", the derivative contract was recorded as "Other payables and accrued liabilities" in the accompanying consolidated balance sheet at fair value. For the year ended December 31, 2004, the Group recognised related changes in fair value, a gain of RMB2,581,000 (2003: RMB10,038,000; 2002: RMB14,485,000), and included the amount in "Exchange gains /(losses), net" in the consolidated income statement.

During 2003, the Group also entered into interest rate swap agreements to partially hedge the fixed-rate debt for interest rate

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risk exposure management purposes with notional contract amount of US\$200 million. The interest rate swap agreements utilised by the Company effectively modifies the Company's exposure to interest risk by converting the Company's fixed-rate debt to a floating rate. These agreements involve the receipt of fixed rate amounts in exchange for floating rate interest payments over the life of the agreement without an exchange of the underlying principal amount. The interest rate swap agreements were settled during the year and the total net gain was RMB84,168,000.

F-58

CNOOC LIMITED AND ITS SUBSIDIARIES  
NOTES TO FINANCIAL STATEMENTS  
(All amounts expressed in Renminbi unless otherwise stated)

### 37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

(d) Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The most significant estimates pertain to proved oil and gas reserve volumes and the future development, provision for dismantlement as well as estimates relating to certain oil and gas revenues and expenses. Actual amounts could differ from those estimates and assumptions.

(e) Segment reporting

The Group's segment information is based on the segmental operating results regularly reviewed by the Group's chief operating decision maker. The accounting policies used are the same as those used in the preparation of the Group's consolidated Hong Kong GAAP financial statements.

(f) Impact of recently issued accounting standards

Statements of Financial Accounting Standards No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets", were issued by the Financial Accounting Standards Board in June 2001 and became effective for the Group on July 1, 2001 and January 1, 2002, respectively. In 2003, the Emerging Issues Task Force (EITF) considered the issue of whether FAS 141 and 142 require interests held under oil, gas and mineral leases to be separately classified as intangible assets on the balance sheets of companies in the extractive industries. If such interests were deemed to be intangible assets by the EITF, mineral rights to extract oil and gas for both undeveloped and developed leaseholds would be classified separately from oil and gas properties as intangible assets on the corporation's balance sheet. Historically the Group has capitalized the acquisition cost of oil and gas properties interests in accordance with statement of Financial Accounting Standard No. 19,

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"Financial Accounting and Reporting by Oil and Gas Producing Companies". Also, consistent with industry practice, the Group has reported these assets as part of property, plant and equipment.

In 2004, the EITF reached a conclusion that mineral rights are tangible assets and the balance sheet classification and disclosures for drilling and mineral rights of Oil and Gas Producing entities are within the scope of Statement of Financial Accounting Standard No.19, "Financial Accounting and Reporting by Oil and Gas Producing Companies". Accordingly, there is no implication to the Company.

F-59

### CNOOC LIMITED AND ITS SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

(All amounts expressed in Renminbi unless otherwise stated)

#### 37. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (CONT'D)

##### (f) Impact of recently issued accounting standards (cont'd)

The Financial Accounting Standards Board (FASB) has proposed an amendment to Statement No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" (FAS No. 19) that may change the way oil and gas producers account for deferred exploratory drilling costs. Under the current rules, there is a presumption that all exploratory drilling costs will be expensed within one year following completion of drilling if proved reserves have not been recorded, except for costs related to areas where additional exploration wells are necessary to justify development plans and such additional wells are under way or firmly planned for the near future.

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." The FASB staff has developed indicators to help determine whether sufficient progress is being made. The Company believes the adoption of the proposed amendment (once finalized) will have no impact on its consolidated financial statements.

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 the Company's 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

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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 rule, FAS No. 123R is now effective for the Company beginning January 1, 2006. The pro forma disclosures previously permitted under FAS No. 123 no longer will be an alternative to financial statement recognition. The Company believes the adoption of the FAS No. 123 will have no material impact on its consolidated financial statements as the Company currently accounts for the stock options under the fair value recognition provision of FAS No. 123.

In May 2003, the FASB issued FAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity", to address the balance sheet classification of certain financial instruments that have characteristics of both liabilities and equity. The Statement, already effective for contracts created or modified after May 31, 2003, was originally intended to become effective July 1, 2003, for all contracts existing at May 31, 2003. However, on November 7, 2003, the FASB issued an indefinite deferral of certain provisions of FAS No. 150. We continue to monitor and assess the FASB's modifications of FAS No. 150, but do not anticipate any material impact to our financial statements.

F-60

CNOOC LIMITED AND ITS SUBSIDIARIES  
SUPPLEMENTARY INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES  
(UNAUDITED)

(All amounts expressed in Renminbi unless otherwise stated)

The following disclosures are included in accordance with the United States Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities".

(a) Reserve quantity information

Crude oil and natural gas reserve estimates are determined through analysis of geological and engineering data which appear, with reasonable certainty, to be recoverable at commercial rates in the future from known oil and natural gas reservoirs under existing economic and operating conditions.

Estimates of crude oil and natural gas reserves have been made by independent engineers. The Group's net proved reserves consist of its percentage interest in reserves, comprised of a 100% interest in its independent oil and gas properties and its participating interest in the properties covered under the production sharing contracts in PRC, less (a) an adjustment for the Group's share of royalties payable by the Group to the PRC government and the Group's participating interest in share oil payable to the PRC government under the production sharing contracts, and less (b) an adjustment for production allocable to foreign partners under the PRC production sharing contracts as reimbursement for exploration

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expenses attributable to the Group's participating interest, and its participating interest in the properties covered under the production sharing contracts in Indonesia less an adjustment of share oil attributable to the Indonesian government and the domestic market obligation.

Proved developed and undeveloped reserves (net of royalties and PRC government share oil):

	PRC		Indonesia	
	Oil (mmbbls)	Natural gas (bcf)	Oil (mmbbls)	Natural gas (bcf)
December 31, 2001	1,279	3,248	--	--
Purchase of reserves	--	--	143	241
Discoveries and extensions	150	169	--	--
Production	( 96)	(79)	(13)	(26)
Revisions of prior estimates	( 46)	( 5)	8	--
December 31, 2002	1,287	3,333	138	215
Purchase of reserves	53	142	--	--
Discoveries and extensions	114	506	1	2
Production	( 97)	(69)	(15)	(37)
Revisions of prior estimates	( 24)	42	(21)	20
December 31, 2003	1,333	3,954	103	200
Purchase of reserves	6	161	--	--
Discoveries and extensions	129	414	4	157
Production	(106)	(103)	(11)	(31)
Revisions of prior estimates	( 8)	(101)	5	( 5)
December 31, 2004	1,354	4,325	101	321

F-61

CNOOC LIMITED AND ITS SUBSIDIARIES  
 SUPPLEMENTARY INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES  
 (UNAUDITED)

(All amounts expressed in Renminbi unless otherwise stated)

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(a) Reserve quantity information (cont'd)

Proved developed reserves:

	PRC		Indonesia	
	Oil (mmbbls)	Natural gas (bcf)	Oil (mmbbls)	Natural gas (bcf)
December 31, 2002	542	724	115	101
December 31, 2003	459	2,054	91	135
December 31, 2004	617	2,134	85	138

(b) Results of operations

	2002			
	PRC	Indonesia	Total	PRC
	RMB'000	RMB'000	RMB'000	RMB'000
Net sales to customers	20,280,746	3,498,548	23,779,294	23,644,659
Operating expenses	(2,440,210)	(1,335,124)	(3,775,334)	(2,903,094)
Production taxes	(1,023,049)	--	(1,023,049)	(1,238,598)
Exploration	(1,286,670)	(31,653)	(1,318,323)	(764,165)
Accretion expense	--	--	--	(93,246)
Depreciation, depletion and amortisation (including dismantlement)	(3,121,381)	(898,151)	(4,019,532)	(3,700,349)
	12,409,436	1,233,620	13,643,056	14,945,207
Income tax expenses	(3,816,008)	(592,138)	(4,408,146)	(4,483,562)
Result of operations	8,593,428	641,482	9,234,910	10,461,645

	2004		
	PRC	Indonesia	Total
	RMB'000	RMB'000	RMB'000
Net sales to customers	32,723,277	4,162,742	36,886,019
Operating expenses	(3,643,182)	(1,427,162)	(5,070,344)
Production taxes	(1,725,674)	--	(1,725,674)
Exploration	(1,202,203)	(113,957)	(1,316,160)

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Accretion expense	(119,707)	--	(119,707)
Depreciation, depletion and amortisation (including dismantlement)	(4,670,988)	(985,711)	(5,656,699)
	-----	-----	-----
Income tax expenses	21,361,523 (6,408,457)	1,635,912 (705,487)	22,997,435 (7,113,944)
	-----	-----	-----
Result of operations	14,953,066	930,425	15,883,491
	=====	=====	=====

(c) Capitalised costs

	2002			PRC
	PRC	Indonesia	Total	
	-----	-----	-----	-----
	RMB'000	RMB'000	RMB'000	RMB'000
Proved oil and gas properties	46,426,684	9,605,744	56,032,428	57,537,676
Unproved oil and gas properties	521,880	--	521,880	713,594
Accumulated depreciation, depletion and amortisation	(21,161,905)	(993,316)	(22,155,221)	(25,740,836)
	-----	-----	-----	-----
Net capitalised costs	25,786,659	8,612,428	34,399,087	32,510,434
	=====	=====	=====	=====

	2004		
	PRC	Indonesia*	Total
	-----	-----	-----
	RMB'000	RMB'000	RMB'000
Proved oil and gas properties	70,931,798	10,100,116	81,031,914
Unproved oil and gas properties	437,513	4,696,237	5,133,750
Accumulated depreciation, depletion and amortisation	(30,462,658)	(3,083,933)	(33,546,591)
	-----	-----	-----



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Net capitalised costs	40,906,653	11,712,420	52,619,073
	=====	=====	=====

F-62

CNOOC LIMITED AND ITS SUBSIDIARIES  
 SUPPLEMENTARY INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES  
 (UNAUDITED)  
 (All amounts expressed in Renminbi unless otherwise stated)

(d) Costs incurred

	2002			PRC
	PRC	Indonesia	Total	
	RMB'000	RMB'000	RMB'000	
Acquisition costs	--	4,735,826	4,735,826	1,579,726
Exploration costs	1,519,683	32,405	1,552,088	1,225,926
Development costs**	5,458,199	750,532	6,208,731	7,489,472
	-----	-----	-----	-----
Total costs incurred	6,977,882	5,518,763	12,496,645	10,295,124
	=====	=====	=====	=====

	2004		
	PRC	Indonesia*	Total
	RMB'000	RMB'000	RMB'000
Acquisition costs	--	3,531,046	3,531,046
Exploration costs	1,806,556	137,361	1,943,917
Development costs**	11,693,183	645,501	12,338,684
	-----	-----	-----
Total costs incurred	13,499,739	4,313,908	17,813,647
	=====	=====	=====

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\* The amounts do not include prepayments made for the NWS Project of RMB4,693,809,000.

\*\* The development costs include estimated future dismantlement costs of dismantling offshore oil platforms and gas properties.

(e) Standardised measure of discounted future net cash flows and changes therein

In calculating the standardised measure of discounted future net cash flows, year-end constant price and cost assumptions were applied to the Group's estimated annual future production from proved reserves to determine future cash inflows. Year end average realised oil prices used in the estimation of proved reserves and calculation of the standardised measure were US\$32 as at December 31, 2004 (2003: US\$30; 2002: US\$28). Future development costs are estimated based upon constant price assumptions and assume the continuation of existing economic, operating and regulatory conditions. Future income taxes are calculated by applying the year-end statutory rate to estimate future pre-tax cash flows after provision for the tax cost of the oil and natural gas properties based upon existing laws and regulations. The discount was computed by application of a 10% discount factor to the estimated future net cash flows.

Management believes that this information does not represent the fair market value of the oil and natural gas reserves or the present value of estimated cash flows since no economic value is attributed to potential reserves, the use of a 10% discount rate is arbitrary, and prices change constantly from year-end levels.

F-63

CNOOC LIMITED AND ITS SUBSIDIARIES  
 SUPPLEMENTARY INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES  
 (UNAUDITED)  
 (All amounts expressed in Renminbi unless otherwise stated)

(e) Standardised measure of discounted future net cash flows and changes therein (cont'd)

Present value of estimated future net cash flows:

2002					
Notes	PRC	Indonesia	Total	PRC	Indo
	RMB'000	RMB'000	RMB'000	RMB'000	RM
Future cash					

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inflows	(1)	389,025,791	37,242,644	426,268,435	422,329,692	30
Future production costs		(89,657,677)	(22,386,603)	(112,044,280)	(106,854,167)	(17)
Future development costs	(2)	(44,699,729)	( 5,381,081)	( 50,080,810)	( 52,917,280)	( 4)
Future income taxes		(73,757,925)	( 4,301,926)	( 78,059,851)	( 72,124,755)	( 3)
Future net cash flows	(3)	180,910,460	5,173,034	186,083,494	190,433,490	5
10% discount factor		(84,478,856)	( 1,463,589)	( 85,942,445)	( 84,550,531)	( 1)
Standardised measure		96,431,604	3,709,445	100,141,049	105,882,959	3

2004

	Notes	PRC	Indonesia	Total
		RMB'000	RMB'000	RMB'000
Future cash inflows	(1)	467,336,822	37,198,784	504,535,606
Future production costs		(115,267,250)	(20,472,914)	(135,740,164)
Future development costs	(2)	( 60,319,348)	( 6,709,341)	( 67,028,689)
Future income taxes		( 78,717,296)	( 4,001,019)	( 82,718,315)
Future net cash flows	(3)	213,032,928	6,015,510	219,048,438
10% discount factor		( 91,755,987)	( 1,905,679)	( 93,661,666)
Standardised measure		121,276,941	4,109,831	125,386,772

- (1) Future cash flows consist of the Group's 100% interest in the independent oil and gas properties and the Group's participating interest in the properties under production sharing contracts in PRC less (a) an adjustment for the royalties payable to the PRC government and share oil payable to the PRC government under production sharing contracts and (b) an adjustment for production allocable to foreign partners under the PRC production sharing contracts for exploration costs attributable to the Group's

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participating interest, plus its participating interest in the properties covered under the production sharing contracts in Indonesia, less an adjustment of share oil attributable to Indonesian government and the domestic market obligation.

- (2) Future development costs include the estimated costs of drilling future development wells and building the production platforms.
- (3) Future net cash flows have been prepared taking into consideration estimated future dismantlement costs of dismantling offshore oil platforms and gas properties.

F-64

CNOOC LIMITED AND ITS SUBSIDIARIES  
SUPPLEMENTARY INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES  
(UNAUDITED)

(All amounts expressed in Renminbi unless otherwise stated)

- (e) Standardised measure of discounted future net cash flows and changes therein (cont'd)

Changes in the standardised measure of discounted future net cash flows:

	2002	2001
	RMB'000	RMB'000
Standardised measure, beginning of year	51,082,458	100,141,049
Sales of production, net of royalties and production costs	(18,980,911)	( 22,345,000)
Net change in prices, net of royalties and production costs	58,471,355	22,321,000
Extensions discoveries and improved recovery, net of related future costs	14,603,893	13,790,000
Change in estimated future development costs	(13,947,849)	( 14,673,000)
Development costs incurred during the year	6,208,731	7,718,000
Revisions in quantity estimates	(3,301,510)	(2,942,000)
Accretion of discount	6,873,378	13,428,000
Net change in income taxes	(23,296,206)	( 6,290,000)
Purchase of properties	15,899,375	5,363,000
Changes in timing and other	6,528,335	( 6,713,000)
	100,141,049	109,799,000
Standardised measure, end of year	100,141,049	109,799,000

