CNOOC LTD
Form 20-F
June 29, 2007

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

FORM 20-F

(Mark One)
¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ________________ to _______________

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report ________________

Commission File Number 1-14966

CNOOC LIMITED
(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 on which registered
American depositary shares, each representing 100 shares of par value HK$0.02 per share	New York Stock Exchange, Inc.
Shares of par value HK$0.02 per share	New York Stock Exchange, Inc.*

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

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

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

Shares, par value HK$0.02 per share	43,328,552,648

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

Yes ý No ¨

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

Yes ¨ No ý

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

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

Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨

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

Item 17 ¨ Item 18 ý

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

Yes ¨ No ý

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

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

Yes ¨ No ¨

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

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TERMS AND CONVENTIONS

Definitions

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

- "CNOOC" are to our controlling shareholder, China National Offshore Oil Corporation, a PRC state-owned enterprise, and its affiliates, excluding us and our subsidiaries;
- "CNOOC Limited," are to CNOOC Limited, a Hong Kong limited liability company and the registrant of this annual report;
- "Our company," "we," "our" or "us" are to CNOOC Limited and its subsidiaries;
- "China" or "PRC" are to the People's Republic of China, excluding for purposes of geographical reference in this annual report, the Hong Kong Special Administrative Region, the Macau Special Administrative Region and Taiwan;
- "Hong Kong Stock Exchange" or "HKSE" are to The Stock Exchange of Hong Kong Limited;
- "Hong Kong Stock Exchange Listing Rules" are to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited;
- "HK$" are to the Hong Kong dollar, the legal currency of the Hong Kong Special Administrative Region;
- "HKFRS" are to all Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards and Interpretations approved by the Council of the Hong Kong Institute of Certified Public Accountants;
- "JPY" are to the Japanese yen, the legal currency of Japan;
- "Rmb" are to the Renminbi, the legal currency of the PRC; and
- "US$" are to the 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 for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006 of US$1.00=Rmb 7.8041. We have also translated amounts in Hong Kong dollars solely for the convenience of the reader at the noon buying rate for cable transfers in Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006 of HK$7.7771 to US$1.00. 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 29, 2006, or at all. For further information on exchange rates, see "Item 3—Key Information—Selected Financial Data."

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

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

- the numerator is equal to the sum of (i) revenues from our oil and gas sales offshore China for the applicable period; (ii) the 30% ownership share of revenues from gas sales for the applicable period from an unconsolidated investee; and (iii) the revenues from oil and gas sales for the applicable period from our overseas interests; and

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

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Our net "proved reserves" consist of our percentage interest in reserves, including our 100% interest in the independent oil and gas properties and our participating interest in the properties covered under the production sharing contracts in the PRC, less: (i) an adjustment for our share of royalties payable by us to the PRC government and our participating interest in share oil payable to the PRC government under the production sharing contracts, and (ii) an adjustment for production allocable to foreign partners under the PRC production sharing contracts as reimbursement for exploration expenses attributable to our participating interest, and plus: (a) our participating interest in the properties in Australia and Nigeria and (b) the participating interest in the properties covered under the production sharing contracts in Indonesia less an adjustment for oil and gas distributed to the Indonesian government and the domestic market obligation.

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.

Unless otherwise noted, all operating data presented in this annual report, including reserve and production information, includes our interest in the oil and gas field held by an unconsolidated investee in which we hold a 30% equity interest. For more information on our reserves and related information, see "Supplementary Information on Oil and Gas Producing Activities" in our consolidated financial statements included elsewhere in this annual report, in which we separately disclose reserve and related information for this unconsolidated investee in accordance with U.S. Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities."

Glossary of Technical Terms

Unless otherwise indicated in the context, references to:

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

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

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

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

- "LNG" means liquefied natural gas.

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

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

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- “exploration well” means a wildcat or appraisal well.

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

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

- “net wells” means a party’s working interest in wells.

- “proved developed reserves” means reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery are included as “proved developed reserves” only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

- “proved reserves” means the estimated quantities of crude oil, natural gas, and natural gas liquids which 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. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

  (i) Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation test. The area of a reservoir considered proved includes:

  (A) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any; and

  (B) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir.

  (ii) Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the “proved” classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based.

  (iii) Estimates of proved reserves do not include the following:

  (A) oil that may become available from known reservoirs but is classified separately as “indicated additional reserves;”

(B) crude oil, natural gas, and natural gas liquids, the recovery of which is subject to reasonable doubt because of uncertainty as to geology, reservoir characteristics, or economic factors;

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(C) crude oil, natural gas, and natural gas liquids, that may occur in undrilled prospects; and

(D) crude oil, natural gas, and natural gas liquids, that may be recovered from oil shales, coal, gilsonite and other such sources.

- "proved undeveloped reserves" means reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage is limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Estimates for proved undeveloped reserves are not attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

- "share oil" means the portion of production that must be allocated to the relevant government entity or company under our production sharing contracts.

For further definitions relating to reserves:

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

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

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

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

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

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

References to:

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

- mmbbls means million barrels;

- BOE means barrels-of-oil equivalent;
- BOE per day means barrels-of-oil equivalent per day;
- million BOE means million barrels-of-oil equivalent;
- mcf means thousand cubic feet;
- mmcf means million cubic feet;
- bcf means billion cubic feet, which is equivalent to approximately 283.2 million cubic meters;
- BTU means British Thermal Unit, a universal measurement of energy; and
- km means kilometers, which is equivalent to approximately 0.62 miles.

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FORWARD-LOOKING STATEMENTS

This annual report includes “forward-looking statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995. The words “believe,” “intend,” “expect,” “anticipate,” “project,” “estimate,” “plan,” “predict” a similar expressions are also intended to identify such forward-looking statements.

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

- the amount and nature of future exploration, development and other capital expenditures,
- wells to be drilled or reworked,
- oil and gas prices and demand,
- future earnings and cash flow,
- development projects,
- exploration prospects,
- estimates of proved oil and gas reserves,
- potential reserves,
- development and drilling potential,
- drilling prospects,
- expansion and other development trends of the oil and gas industry,
- business strategy,
- production of oil and gas,
- development of undeveloped reserves,
- expansion and growth of our business and operations, and
- our estimated financial information.

These statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate under the circumstances. However, whether actual results and developments will meet our expectations and predictions depend on a number of risks and uncertainties which could cause our actual results, performance and financial condition to differ materially from our expectations, including those associated with fluctuations in crude oil and natural gas prices, our exploration or development activities, our capital expenditure requirements, our business strategy, the highly competitive nature of the oil and natural gas industries, our foreign operations, environmental liabilities and compliance requirements, and economic and political conditions in the PRC. For a description of these and other risks and uncertainties, see “Item 3–Key Information–Risk Factors.”

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

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

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

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

The Hong Kong Institute of Certified Public Accountants issued a number of new and amended Hong Kong Financial Reporting Standards, or HKFRS, which were mandatory for annual periods beginning on or after January 1, 2006. Details of such new and amended HKFRSs are included in note 2.1 to our consolidated financial statements included elsewhere in this annual report.

We have prepared and presented our consolidated financial statements in accordance with Hong Kong generally accepted accounting principles ("Hong Kong GAAP"). For an explanation of the reconciliation of our profit and shareholders' equity to U.S. generally accepted accounting principles ("US GAAP"), see note 38 to our consolidated financial statements included elsewhere in this annual report.

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	Year ended December 31,					
	2002	**2003**	**2004**	**2005**	**2006**	**2006**
	Rmb	**Rmb**	**Rmb**	**Rmb**	**Rmb**	**US$**
	(in millions, except per share and per ADS data)					
Income Statement Data:						
Hong Kong GAAP						
Operating revenues:						
Oil and gas sales	23,779	28,117	36,886	53,418	67,828	8,691
Marketing revenues	2,377	12,399	18,191	15,901	20,964	2,686
Other income	217	434	145	137	155	20
Total operating revenues	26,374	40,950	55,222	69,456	88,947	11,397
Expenses:						
Operating expenses	(3,775)	(4,513)	(5,070)	(5,935)	(6,999)	(897)
Production taxes	(1,023)	(1,239)	(1,726)	(2,597)	(3,316)	(425)
Exploration expenses	(1,318)	(848)	(1,316)	(1,294)	(1,705)	(218)
Depreciation, depletion and amortization	(4,020)	(4,643)	(5,455)	(5,965)	(6,933)	(888)
Dismantlement	(126)	(167)	(202)	(253)	(472)	(61)
Special oil gain levy	—	—	—	—	(3,981)	(510)
Impairment losses related to property, plant and equipment	—	—	—	(90)	(252)	(32)
Crude oil and product purchases	(2,326)	(12,295)	(17,963)	(15,704)	(20,573)	(2,636)
Selling and administrative expenses	(1,033)[(e)]	(1,250)[(e)]	(1,104)[(e)]	(1,370)	(1,544)	(198)
Others	(31)	(350)	(46)	(76)	(117)	(15)
	(13,652)	(25,305)	(32,882)	(33,284)	(45,892)	(5,880)
Interest income	148	184	207	359	781	100
Finance costs	(295)	(355)	(442)	(1,100)	(1,832)	(235)
Exchange gains/ (losses), net	(114)	(7)	29	287	308	40
Investment income	193	124	72	248	613	79
Share of profits of associates	165	220	344	307	322	41
Non-operating income/ (expenses), net	(71)	315	519	28	876	112
Profit before tax	12,748	16,125	23,070	36,301	44,123	5,654
Tax	(3,541)	(4,628)	(6,931)	(10,978)	(13,196)	(1,691)
	9,207	11,497	16,139	25,323	30,927	3,963

Profit for the year						
Earnings per share (basic)[(a)(b)]	0.22	0.28	0.39	0.62	0.73	0.09
Earnings per share (diluted)[(a)(c)]	0.22	0.28	0.39	0.61	0.73	0.09
Earnings per ADS (basic)[(a)(b)]	22.42	27.99	39.31	61.68	72.75	9.32
Earnings per ADS (diluted)[(a)(c)]	22.40	27.97	39.19	61.01	72.64	9.31
Dividend per share[(a)]						
Special interim dividend declared in place of 2003 final dividend[(d)]	—	—	0.060	—	—	—
Interim	0.024	0.030	0.030	0.052	0.123	0.016
Interim (in US$)	0.003	0.004	0.004	0.006	—	—
Special interim	—	0.038	0.050	0.052	—	—
Special interim (in US$)	—	0.005	0.006	0.006	—	—
Proposed final[(d)]	0.032	0.026	0.030	0.103	0.139	0.018
Proposed final (in US$)[(d)]	0.004	0.003	0.004	0.013	—	—
Proposed special final[(d)]	0.032	0.038	0.050	—	—	—
Proposed special final (in US$)[(d)]	0.004	0.005	0.006	—	—	—
U.S. GAAP						
Operating revenues:						
Oil and gas sales	23,779	28,117	36,886	53,418	67,828	8,691
Marketing revenues	2,377	12,399	18,191	15,901	20,964	2,686
Other income	217	434	145	137	155	20
Total operating revenues	26,374	40,950	55,222	69,456	88,947	11,397
Profit for the year	9,086	11,980	16,176	25,343	31,104	3,986

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	Year ended December 31,					
	2002	**2003**	**2004**	**2005**	**2006**	**2006**
	Rmb	**Rmb**	**Rmb**	**Rmb**	**Rmb**	**US$**
	(in millions, except per share and per ADS data)					
Earnings per share (basic)[(a)(b)]	0.22	0.29	0.39	0.62	0.73	0.09
Earnings per share (diluted)[(a)(c)]	0.22	0.29	0.39	0.61	0.73	0.09
Earnings per ADS (basic)[(a)(b)]	22.12	29.17	39.40	61.73	73.16	9.38
Earnings per ADS (diluted)[(a)(c)]	22.13	29.14	39.28	61.06	73.05	9.36

	As of December 31,					
	2002	**2003**	**2004**	**2005**	**2006**	**2006**
	Rmb	**Rmb**	**Rmb**	**Rmb**	**Rmb**	**US$**
	(in millions)					
Balance Sheet Data:						
Hong Kong GAAP						
Cash and cash equivalents	7,839	14,400	14,092	8,992	14,364	1,841
Time deposits with maturity over three months	4,690	2,323	8,603	12,200	9,233	1,183
Available-for sale financial assets/Short term investments	6,531	5,684	5,444	13,847	12,390	1,588
Current assets	24,486	29,263	35,293	44,421	47,892	6,137
Property, plant and equipment, net	35,797(f)	42,849(f)	57,182(f)	66,625	103,406	13,250
Interests in associates	537	1,118	1,327	1,402	1,544	198
Intangible assets	—	—	—	1,300	1,409	181
Long term available-for-sale financial assets	—	—	—	1,017	1,017	130
Total assets	60,820(f)	73,229(f)	93,802(f)	114,765	155,268	19,896
Current liabilities	7,134	9,307	10,402	13,616	14,481	1,856
Long term bank loans, net of current portion	941	890	865	24	2,438	312
Long term guaranteed notes	4,071	8,142	16,313	16,532	17,886	2,292
Total long term liabilities	13,393	17,461	26,957	27,546	32,973	4,225
Total liabilities	20,527	26,768	37,359	41,162	47,454	6,081
Minority interest	—	—	—	—	42	5
Shareholders' equity	40,293(e),(f)	46,461(e),(f)	56,443(e),(f)	73,603	107,772	13,810
U.S. GAAP						

Total assets	60,444	73,234	93,846	114,809	171,579	21,986
Total long term liabilities	13,393	17,461	26,957	27,546	49,063	6,287
Minority interest	—	—	—	—	42	5
Shareholders' equity	40,344	46,496	56,487	73,647	107,993	13,838

(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) Earnings per share (basic) and earnings per ADS (basic) for 2002 and 2003 have been computed, without considering the dilutive effect of the shares underlying our share option scheme, by dividing profit 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. Earnings per share (basic) and earnings per ADS (basic) for 2004 have been computed, without considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by dividing profit 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. Earnings per share (basic) and earnings per ADS (basic) for 2005 have been computed, without considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by dividing profit by the weighted average number of shares and the weighted average number of ADSs of 41,054,499,982 and 410,545,000 respectively (based on a ratio of 100 shares to one ADS) for the period. Earnings per share (basic) and earnings per ADS (basic) for 2006 have been computed, without considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by dividing profit by the weighted average number of shares and the weighted average number of ADSs of 42,512,190,394 and 425,121,904 respectively (based on a ratio of 100 shares to one ADS) for the period.

(c) Earnings per share (diluted) and earnings 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. Earnings per share (diluted) and earnings 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. Earnings per share (diluted) and earnings 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. Earnings per share (diluted) and earnings per ADS (diluted) for 2005 have been computed, after considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, by using 42,386,055,766 and 423,860,558 respectively. Earnings per share (diluted) and earnings per ADS (diluted) for 2006 have been computed, after considering the dilutive effect of the shares underlying our share option scheme and convertible bonds, using 42,577,841,013 and 425,778,410 respectively.

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

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

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(f) In 2005, we restated certain prior year amounts upon adoption of new Hong Kong accounting policies. For example, in prior periods, we classified the on-shore processing plants as land and buildings and depreciated over 30-50 years on a straight-line basis. Upon the adoption of HKAS 16, we have retrospectively reclassified our property, plant and equipment into two categories: oil and gas properties, and vehicles and office equipment. We have reclassified the onshore terminals previously classified as land and buildings to oil and gas properties as they will be used in similar operations and are expected to have similar economic useful lives. We also changed our accounting policy retrospectively for 2002, 2003 and 2004 to state the onshore terminals at cost instead of valuation and to amortize those terminals by the unit-of-production method on a property-by-property basis.

	Year ended December 31,					
	2002 Rmb	**2003 Rmb**	**2004 Rmb**	**2005 Rmb**	**2006 Rmb**	**2006 US$**
	(in millions, except percentages and ratios)					
Other Financial Data:						
Hong Kong GAAP						
Capital expenditures paid[(1)]	6,833	8,272	12,843	16,606	23,041	2,952
Cash provided by (used for):						
Operating activities	14,742	17,819	22,328	32,154	39,226	5,026
Investing activities	(11,724)	(9,513)	(24,607)	(29,349)	(39,526)	(5,065)
Financing activities	(1,573)	(1,745)	1,970	(7,786)	6,039	774
Ratio of total debt to total capitalization[(2)]	11.6%	16.2%	23.3%	19.1%	15.5%	15.5%
U.S. GAAP						
Cash provided by (used for):						
Operating activities	14,742	17,819	22,328	32,154	39,226	5,026
Investing activities	(11,724)	(9,513)	(24,607)	(29,349)	(39,526)	(5,065)
Financing activities	(1,573)	(1,745)	1,970	(7,786)	6,039	774
Ratio of cash provided by operating activities to gross interest expense[(3)]	36.4x	35.1x	39.4x	41.5x	40.4x	40.4x
Ratio of total debt to cash provided by operating activities	0.4x	0.5x	0.8x	0.5x	0.5x	0.5x
Profit for the year	9,086	11,980	16,176	25,343	31,104	3,986
Profit for the year margin[(4)]	34.5%	29.3%	29.3%	36.5%	35.0%	35.0%
Ratio of profit to gross interest expense[(3)]	22.4x	23.6x	28.5x	32.7x	32.0x	32.0x
Ratio of total debt to profit	0.6x	0.8x	1.1x	0.7x	0.8x	0.8x

Ratio of total debt to total capitalization(2)	11.8%	16.3%	23.4%	19.1%	15.5%	15.5%

(1) Capital expenditures paid excludes acquisition capital expenditures.
(2) Total capitalization excludes current portion of long-term debt.
(3) Gross interest expense includes capitalized interest.
(4) Profit margin represents profit as a percentage of our total operating revenues, as computed under U.S. GAAP.

We publish our financial statements in Renminbi. Unless otherwise indicated, all translations from Renminbi to U.S. dollars have been made at a rate of Rmb7.8041 to US$1.00, the noon buying rate for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006. 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 above or at all.

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

	Noon Buying Rate			
Period	**End**	**Average(1)**	**High**	**Low**
	(Rmb per US$1.00)			
2002	8.2800	8.2772	8.2800	8.2669
2003	8.2767	8.2771	8.2800	8.2765
2004	8.2765	8.2768	8.2774	8.2764
2005	8.0702	8.1998	8.2765	8.0702
2006	7.8041	7.9723	8.0702	7.8041
December 2006	7.8041	—	7.8350	7.8041
January 2007	7.7714	—	7.8127	7.7705

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February 2007	7.7410	—	7.7632	7.7410
March 2007	7.7232	—	7.7454	7.7232
April 2007	7.7090	—	7.7345	7.7090
May 2007	7.6516	—	7.7065	7.6463

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

As of May 31, 2007, the noon buying rate for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York was Rmb7.6516 to US$1.00.

The Hong Kong dollar is freely convertible into the U.S. dollar. Since 1983, the Hong Kong dollar has been linked to the U.S. dollar. The Hong Kong government has also stated that it has no intention of imposing exchange controls in Hong Kong and that the Hong Kong dollar will remain freely convertible into other currencies, including the U.S. dollar. However, we cannot assure that the Hong Kong government will maintain the link at HK$7.80 to US$1.00 or at all. Unless otherwise indicated, all translations from Hong Kong dollars to U.S. dollars have been made at a rate of HK$7.7771 to US$1.00, the noon buying rate for cable transfers in Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006. We do not represent that Hong Kong dollar or U.S. dollar amounts could be converted into U.S. dollars or Hong Kong dollars, as the case may be, at any particular rate, the rate above or at all.

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

	Noon Buying Rate			
Period	**End**	**Average(1)**	**High**	**Low**
	(HK$ per US$1.00)			
2002	7.7988	7.7996	7.8095	7.7970
2003	7.7640	7.7864	7.8001	7.7285
2004	7.7723	7.7891	7.8010	7.7632
2005	7.7533	7.7755	7.7999	7.7514
2006	7.7771	7.7681	7.7928	7.7506
December 2006	7.7771	—	7.7787	7.7665
January 2007	7.8078	—	7.8112	7.7797
February 2007	7.8119	—	7.8141	7.8041
March 2007	7.8137	—	7.8177	7.8093
April 2007	7.8212	—	7.8212	7.8095
May 2007	7.8087	—	7.8236	7.8044

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

As of May 31, 2007, 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$7.8087 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

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

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

- political developments in petroleum producing regions;
- the ability of the Organization of Petroleum Exporting Countries and other petroleum producing nations to set and maintain production levels and prices;
- the price and availability of other energy sources, such as coal;
- domestic and foreign government regulations;
- weather conditions; and
- overall economic conditions.

Our revenues and profit have increased significantly in the past five years, mainly due to increasing oil prices. However, we can not assure that oil prices will remain high in the future. In 2006, oil prices for West Texas Intermediate, the international benchmark for crude oil, decreased 3.8% from US$63.45 per barrel on January 3, 2006 to US$61.05 per barrel on December 29, 2006. The conflict and turmoil in the Middle East in the past four years have raised concerns about the security and availability of ample supplies to meet growing global demand. West Texas Intermediate reached a high in 2006 of US$77.03 per barrel on July 14, 2006 and was US$64.01 per barrel on May 31, 2007. For a description of oil prices in recent years, see "Item 4—Information on the Company—Business Overview—Sales and Marketing—Sales of Crude Oil—Pricing" in this annual report. Any future declines in oil and gas prices would adversely affect our revenues and profit.

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

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

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

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

- the quality and quantity of technical and economic data;

- the prevailing oil and gas prices for our production;
- the production performance of reservoirs;
- extensive engineering judgments; and

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

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

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

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

Approximately 55.0% of our proved reserves were undeveloped as of December 31, 2006. 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 approximately US$4,418 million to develop our oil and gas properties and US$522 million for exploration in 2007. 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, profit and cash flows depends upon continued capital spending. We adjust our capital expenditure and investment budget each year. Our capital expenditure plans are subject to a number of contingencies, some of which are beyond our control. These variables include:

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

- the availability and terms of external financing;

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

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

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

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

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

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

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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:

- we have limited experience in investing in liquefied natural gas facilities, gas transmission and distribution systems, and overseas upstream natural gas properties;
- any additional capital expenditures that are necessary to implement our natural gas strategy could divert resources from our core oil and gas exploration and production business and require us to seek additional financing;
- our new natural gas operations may face additional competition from a number of international and PRC companies. In particular, PetroChina Company Limited, or PetroChina, has constructed natural gas pipelines to link its natural gas fields located in the western part of China to the eastern coastal regions;
- our new natural gas activities may subject us to additional government regulation in China and foreign countries and regions;
- our overseas natural gas businesses are subject to economic and political risks in the relevant countries and regions. See "Item 3—Key Information—Risk Factors— Risks relating to our business—We are exposed to operating risks in some foreign countries and regions as a result of our acquisition of oil and gas interests located in these regions;"
- we do not have the same preferential rights or access to natural gas businesses or overseas natural gas investments that we enjoy with respect to our upstream natural gas business offshore China; and
- we are evaluating the options to invest in CNOOC's liquefied natural gas projects in China. However, we have not decided whether to exercise these options. The options are subject to various conditions, including the receipt of certain governmental approvals.

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

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

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

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

CNOOC indirectly owned 66.41% of our shares as of May 31, 2007. 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. Therefore, CNOOC may cause us to enter into transactions, to take or fail to take, other actions, or to make decisions that conflict with the best interests of our other shareholders. If CNOOC takes actions that favor its interests over ours, our results of operations and financial position may be adversely affected.

In addition, we regularly enter into transactions with CNOOC and its affiliates, such as China Oilfield Services Limited and Offshore Oil Engineering Co., Ltd. For the year ended December 31, 2006, oil and natural gas sales to CNOOC and its affiliates accounted for 39.9% of our total revenues. For further details, see "Item 7—Major Shareholders and Related Party Transactions." Some of our transactions with CNOOC and its affiliates constitute connected transactions under the Hong Kong Stock Exchange Listing Rules. However, these connected transactions are subject to review by the Hong Kong Stock Exchange and may also be subject to the prior approval of our independent shareholders. If we do not obtain these approvals, we will not be allowed to effect these transactions and our business operations and financial condition could be adversely affected.

Under current PRC law, CNOOC has the exclusive right to enter into production sharing contracts with foreign oil and gas companies for petroleum exploration and production offshore China, and we are restricted from contracting directly with foreign enterprises for these purposes without CNOOC. 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. The interests of CNOOC in entering into production sharing contracts with international oil and gas companies may differ from our interests, especially with respect to the criteria for determining whether, and on what terms, to enter into production sharing contracts. Our future business development may be adversely affected if CNOOC does not enter into new production sharing contracts on terms that are acceptable to us.

Our business performance relies heavily on our sales to domestic customers and a substantial drop in sales in the domestic market could have a material adverse effect on our results of operations

We sell a significant proportion of our production to CNOOC-affiliated companies and China Petroleum & Chemical Corporation, or Sinopec. For the years ended December 31, 2004, 2005 and 2006, sales to CNOOC-affiliated companies accounted for 25.3%, 38.3% and 39.9%, respectively, of our total operating revenues, and sales to Sinopec accounted for 19.3%, 22.5% and 21.6%, respectively, of our total operating revenues. CNOOC has a controlling interest in us. However, our transactions with CNOOC-affiliated companies are on commercial terms and CNOOC does not guarantee our sales volume or profit margin. Sinopec has its own oil and gas fields and has the right to import crude oil directly from the international market. We do not have any long-term crude oil sales contracts with CNOOC and its affiliates or Sinopec. Our business, results of operations and financial condition would be adversely affected if either CNOOC-affiliated companies or Sinopec significantly reduced their crude oil purchases from us and we could not find other ready buyers in the international market to purchase our crude oil at comparable prices and in comparable volumes.

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

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

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

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CNOOC has undertaken to us that so long as it retains a controlling interest in us and our securities are listed on the Hong Kong Stock Exchange, the New York Stock Exchange or other securities trading systems in other parts of the world, we will have the exclusive right to exercise CNOOC's rights to engage in offshore oil and gas exploration, development, production and sales in the PRC and that it will not compete with us in such business. However, CNOOC's controlling interest in us may not continue in the future and CNOOC's undertaking may be subject to interpretative challenges. See "Item 4—Information on the Company—Organizational Structure" and "Item 7—Major Shareholders and Related Party Transactions."

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

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

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

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

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

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

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

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

We have acquired interests in oil and gas properties located in various foreign countries and regions, including Indonesia, Australia, Nigeria, Canada and Myanmar. See "Item 4—Information on the Company—Business Overview—Overseas Activity," and "Item 5—Operating and Financial Review and Prospects—Operating Results—Acquisitio and Overseas Activities." These interests are subject to operating risks in their respective regions, including economic and political risks.

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

Our controlling shareholder, CNOOC, or its affiliates may enter into activities in certain countries that are the subject of U.S. sanctions, which could result in negative media and investor attention.

CNOOC owns 66.41% of our outstanding shares, and is therefore our controlling shareholder. Although we do not engage in any activities in countries that are the subject of U.S. economic sanctions, CNOOC or its affiliates may from time to time engage in such activities.

We cannot predict the interpretation or implementation of U.S. government policy under the Iran Sanctions Act or other relevant measures with respect to any current or future activities by CNOOC or its affiliates in Iran or other countries that are the subject of U.S. sanctions. It is possible that the United States could subject CNOOC to sanctions due to these activities.

It is possible that as a result of activities by CNOOC or its affiliates in these countries, we may be subject to negative media or investor attention, which may distract management, consume internal resources and affect investors' perception of our company. Nonetheless, if such events were to occur, we do not believe that enforcement of U.S. sanctions (including the imposition of the maximum sanctions under the current law and regulations on CNOOC) would have a material adverse effect on our results of operations or financial condition.

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

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

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

- our results of operations, financial condition and cash flows;
- the amount of capital that other PRC and Hong Kong entities may seek to raise in the international capital markets;

- economic, political and other conditions in the PRC and Hong Kong;
- the PRC government’s policies relating to foreign currency borrowings; and

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- 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, profit and cash flows could be adversely affected. For additional information on our capital expenditure plans and financing requirements, see "Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources."

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

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

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

- impose fees for the discharge of waste substances;
- require the payment of fines and damages for serious environmental pollution; and
- provide that the government may, at its discretion, close or suspend any facility which fails to comply with orders requiring it to cease or cure operations causing environmental damage.

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

Risks relating to the PRC petroleum industry

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

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

In addition, existing PRC regulations require us to apply for and obtain various PRC government licenses and other approvals, including in some cases approvals for amendments and extensions of existing licenses and approvals, to conduct exploration and development activities offshore China. If we are unable to obtain any necessary approvals, our reserves and production would be adversely affected. In March 2006, the PRC government imposed a special oil gain levy on revenues generated from sales of domestically produced crude oil when the realized price exceeds US$40 per barrel. In November 2006, the PRC government also imposed an export tariff of 5% on crude oil. We expect the oil gain levy and the export tariff to have an adverse effect on our results of operations. See “Item 4—Information on the Company—Regulatory Framework.”

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Risks relating to the PRC

PRC economic and political conditions may adversely affect our operations

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

- government investment;
- level of development;
- control of capital investment;
- control of foreign exchange; and
- allocation of resources.

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

The PRC government has implemented various policies from time to time to restrain the rate of such economic growth, control inflation and otherwise regulate economic expansion. Severe measures or other actions by the PRC government, such as placing additional controls on prices of petroleum and petroleum products, could restrict our business operations and adversely affect our financial position.

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

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

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

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

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The value of the Renminbi against Hong Kong dollar, U.S. dollar and other currencies fluctuates and is affected by, among other things, changes in China's political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the People's Bank of China. The official exchange rate for the conversion of Renminbi into U.S. dollar has generally been stable during the past 10 years. On July 21, 2005, China reformed its foreign exchange regime by moving into a managed floating exchange rate system based on market supply and demand with reference to a basket of currencies. Renminbi is no longer pegged to the U.S. dollar. From that day to May 31, 2007, Renminbi appreciated about 8.18% against the U.S. dollar. Changes in the PRC government's currency policies may lead to further fluctuations in the exchange rates for the conversion of Renminbi into foreign currencies which could have an uncertain effect on our business and operating results.

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

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

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

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

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

The PRC government underwent substantial reforms after the National People's Congress meeting in March 2003. The PRC government has reiterated its policy of furthering reforms in the socialist market economy. No assurance can be given that these changes will not have an adverse effect on business conditions in China generally or on our business in particular.

Risks relating to our ADSs and shares

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

Sales, or the real or perceived possibility of sales, of a significant number of additional shares in the public market could adversely affect prevailing market prices for our shares and ADSs. As of May 31, 2007, CNOOC, through its wholly owned subsidiaries, CNOOC (BVI) Limited and Overseas Oil & Gas Corporation Ltd., held approximately 66.41% of our shares and the rest of our shares were held by public investors, including institutional investors. We cannot predict the effect, if any, that sales of our shares, including sales of large positions held by institutional and corporate investors, or the availability of our shares for future sale, will have on the market price of our shares or ADSs.

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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 Hong Kong Companies Ordinance. 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.

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

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

- exercising the exclusive right to cooperate with foreign partners in offshore petroleum exploration, development, production and sales activities, and taking participating interests in production sharing contracts;
- organizing international bidding for offshore petroleum exploitation;
- conducting independent exploration, development, production and sales activities in independently operated oil and gas fields offshore China;
- awarding projects to and signing bilateral contracts with foreign partners for offshore petroleum exploitation;
- reviewing and confirming appraisal reports and overall development plans required under production sharing contracts; and
- obtaining from the PRC government all approvals, permits, licenses, consents and special policies necessary under production sharing contracts.

Reorganization

Pursuant to CNOOC's internal business reorganization in 1999, CNOOC transferred all of its then and current operational and commercial interests in its offshore petroleum business, including the related assets and liabilities, to us. CNOOC also transferred 917 employees to us to facilitate the transfer of the oil and natural gas businesses previously operated by CNOOC. 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.

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CNOOC retained its commercial interests in operations and projects not related to oil and gas exploration and production, as well as all of its administrative functions, which it performed prior to the reorganization, including:

- organizing international bidding for offshore petroleum exploitation;
- awarding projects to and signing bilateral contracts with foreign partners for offshore petroleum exploitation;
- approving any extension of the period for the completion of the appraisal work on petroleum discovery under the production sharing contracts; and
- submitting the overall development plans, reports of the oil and gas fields and the environmental impact statements related to the production sharing contracts to the PRC governmental authorities.

Undertakings

CNOOC has undertaken to us that:

- we will enjoy the exclusive right to exercise all of CNOOC's commercial and operational rights under the PRC laws and regulations relating to the exploration, development, production and sales of oil and natural gas offshore China;
- 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;
- 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;
- 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;

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- 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;

- we will have an option to make investment in liquefied natural gas projects in which 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

- we will have an option to participate in other businesses related to natural gas in which CNOOC invested or proposed to invest, and CNOOC will procure all necessary government approvals needed for our participation in such business.

The undertakings from CNOOC will cease to have any effect:

- if we become a wholly owned subsidiary of CNOOC;

- if our securities cease to be listed on any stock exchange or automated trading system; or

- 12 months after CNOOC or any other PRC government-controlled entity ceases to be our controlling shareholder.

B. BUSINESS OVERVIEW

Overview

We are an oil and gas company engaged in the exploration, development and production of crude oil and natural gas primarily offshore China. We are the dominant producer of crude oil and natural gas offshore China and the only company permitted to conduct exploration and production activities with foreign oil and gas companies offshore China. As of December 31, 2006, we had estimated net proved reserves of 2,528.5 million BOE, comprised of 1,489.8 million barrels of crude oil and condensate and 6,231.6 billion cubic feet of natural gas. For 2006, our net production averaged 372,720 barrels per day of crude oil, condensate and natural gas liquids and 490.9 million cubic feet per day of natural gas, which together totaled 457,482 BOE per day. Unless otherwise noted, all operating data presented in this annual report, including reserve and production information, includes our interest in the oil and gas field held by an unconsolidated investee in which we hold a 30% equity interest. For more information on our reserves and related information, see “Supplementary Information on Oil and Gas Producing Activities” in our consolidated financial statements included elsewhere in this annual report, in which we separately disclose reserve and related information for this unconsolidated investee in accordance with U.S. Statement of Financial Accounting Standards No. 69, “Disclosures about Oil and Gas Producing Activities.”

Our net proved reserves increased from 2,362.6 million BOE as of December 31, 2005 to 2,528.5 million BOE as of December 31, 2006, representing an increase of 7.02%. 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, 2006, approximately 55.0% of our net proved reserves were classified as net proved undeveloped. We plan to spend approximately US$4,418.3 million developing our reserves and US$522.5 million for exploration in 2007.

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, 2006, independent properties accounted for 60.4% of our total net proved reserves and independent net proved undeveloped reserves accounted for 63.3% of our total net proved undeveloped reserves. We are the operator of all of our independent producing properties. For the year ended December 31, 2006, production from our independent properties accounted for 47.5% of our total net production.

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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, 2006, we had 27 foreign partners under our existing production sharing contracts offshore China, all of which are international oil and gas companies, including BG International Ltd., BP China Exploration & Production Company, Burlington Resources China LLC, ChevronTexaco China Energy Company, ConocoPhillips China Inc., Devon Energy China Ltd., ENI China B.V., Horizon Oil Ltd., Husky Oil China Ltd., Kerr-McGee China Petroleum Ltd., Newfield China LDC., Roc Oil (China) Company, Shell China Exploration and Production Co., Ltd. and Texas American Resources-Asia Limited. As of December 31, 2006, we were a party to 37 production sharing contracts offshore China. We are currently the operator or joint operator of some 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 explore for natual gas and develop our natural gas properties. We have also made strategic investments in liquefied natural gas related upstream projects outside the PRC, and may continue to do so in the future. We have acquired interests in gas reserves located in Tangguh, Indonesia and the North West Shelf of Australia. In addition, CNOOC, our controlling shareholder, has granted us an option to invest in liquefied natural gas projects or other natural gas related business in which CNOOC invested or proposed to invest. The terms of this option require us, if we exercise the option, to reimburse CNOOC for any contribution CNOOC has made with respect to the project together with interest calculated at the prevailing market rate. CNOOC's major liquefied natural gas projects in the PRC, which it has entered into with various partners, include LNG terminals under production or development in Guangdong, Fujian, Zhejiang and Shanghai.

Competitive Strengths

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

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

Large proved reserve base with significant exploitation opportunities

Based on net proved reserves as of December 31, 2006 and average net daily production for the year ended December 31, 2006, we had a reserve-to-production ratio of 15.1 years. As of December 31, 2006, approximately 55.0% of our net proved reserves were classified as net proved undeveloped. Our large proved reserve base gives us the opportunity to achieve substantial production growth.

Sizable operating area with demonstrated exploration potential

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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. Since CNOOC's inception in 1982 to the end of 2006, a total of 865 exploration wells have been drilled offshore China, including 557 wildcat wells with a success rate of approximately 35%. During the past five years ended December 31, 2006, we and foreign partners made 36 discoveries and 19 discoveries offshore China, respectively.

Successful independent exploration and development record.

From the inception of CNOOC in 1982 to December 31, 2006, we achieved a success rate of approximately 42% on our 262 offshore China independent wildcat wells, while our foreign partners achieved a success rate of approximately 28% on their 295 offshore China wildcat wells. As of December 31, 2006, independent properties accounted for 60.4% of our total net proved reserves and independent net proved undeveloped reserves accounted for 63.3% of our total net proved undeveloped reserves. In 2006, we, acting as operator, completed four of our major development projects on time and under budget.

Competitive cost structure

For the year ended December 31, 2006, our total offshore China lifting costs were US$7.30 per BOE. Total lifting costs for independent operations offshore China were US$6.85 per BOE during the same period. Lifting costs consist of operating expenses and production taxes. We have kept our offshore China lifting costs low through various measures, including more efficient use of existing offshore facilities, the linking of employee bonuses to cost reduction and the adoption of new technology in our operations. We believe that such cost structure allows us to compete effectively even in a low crude oil price environment.

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

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

Strategic position in China's growing natural gas markets

The proximity of our natural gas reserves to the major demand areas in the coastal regions of China provides us with a competitive advantage over other natural gas suppliers in China, whose natural gas reserves are located primarily in northwest and southwest China. We have natural gas fields near many of China's rapidly growing coastal areas, including Hong Kong, Shanghai and Guangzhou. We have also acquired interests in gas reserves located in Tangguh, Indonesia and the North West Shelf of Australia. In addition, CNOOC has granted us an option to invest in liquefied natural gas projects or other natural gas related businesses in the PRC in which CNOOC invested or proposed to invest. For further information, see "Item 4—Information on the Company—Business Overview—Overview."

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 directors and senior management. See "Item 6—Directors, Senior Management and Employees—Share Ownership."

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Business Strategy

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

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

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

As of December 31, 2006, approximately 55.0 % 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. We plan to spend approximately US$3,319.1 million in 2007 to develop our net proved undeveloped reserves offshore China. We also plan to spend approximately US$1,099.3 million to develop our overseas reserves in 2007.

Add to our reserves through independent exploration and production sharing contracts

We plan to concentrate our independent exploration efforts in existing operating areas. We plan to spend approximately US$522.5 million in 2007 on exploration activities. We plan to increase independent exploration efforts while continuing to enter into production sharing contracts with foreign partners to lower capital requirements and exploration risks. In 2007, we plan to drill approximately 54 exploration wells, and independently acquire approximately 9,600 kilometers and 5,000 square kilometers of 2D seismic data and 3D seismic data, respectively. Our foreign partners under existing production sharing contracts plan to drill approximately 29 exploration wells, and acquire approximately 11,400 kilometers and 15,552 square kilometers of 2D seismic data and 3D seismic data, respectively, in 2007.

Capitalize on the growing demand for natural gas in China

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

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

- evaluate investment opportunities in related natural gas businesses that will help develop markets for our natural gas production.

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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 and 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. We evaluate acquisition opportunities based on our expected economic return criteria. Since 2002, we have made a number of acquisitions overseas, expanding our operations to Indonesia, Australia, Canada, Kenya, Equatorial Guinea, Myanmar, Nigeria and the Philippines. See "Item 4—Information on the Company—Business Overview——Oversea Activity."

Maintain operational efficiency and low production costs

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

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

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

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

Maintain financial flexibility through prudent financial practices

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

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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. Unless otherwise noted, all operating data presented in this annual report, including reserve and production information, includes our interest in the oil and gas field held by an unconsolidated investee in which we hold a 30% equity interest. For more information on our reserves and related information, see "Supplementary Information on Oil and Gas Producing Activities" in our consolidated financial statements included elsewhere in this annual report, in which we separately disclose reserve and related information for this unconsolidated investee in accordance with U.S. Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities."

	Year ended December 31,		
	2004	**2005**	**2006**
Net Production:			
Oil (daily average bbls/day)	319,436	356,868	372,720
Gas (daily average mmcf/day)	364.1	389.6	490.9
Oil equivalent (BOE/day)	382,513	424,108	457,482
Average net realized prices:			
Oil (per bbl)	US$35.41	US$47.31	US$58.90
Gas (per mcf)	2.75	2.82	3.05
Offshore China lifting costs (per BOE)	5.31	6.34	7.30
Overseas lifting costs (per BOE)	10.72	12.41	14.07
Net Proved Reserves (end of period):			
Oil (mmbbls)	1,455.6	1,457.4	1,489.8
Gas (bcf)	4,646.6	5,430.9	6,231.6
Total (million BOE)	2,230.0	2,362.6	2,528.5
Proved developed reserves (million BOE)	1,080.7	1,159.8	1,136.7
Annual reserves replacement ratio	173%	186%	199%
Estimated reserves life (years)	15.9	15.3	15.1
Standardized measure of discounted future net cash flow (million Rmb)	124,412	198,316	196,614

At our request, Ryder Scott Company, an independent petroleum engineering consulting company, carried out an independent evaluation of the reserves of all our properties as of December 31, 2004, 2005 and 2006, except the reserves of OML130 project in Nigeria, which were evaluated by us. 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 "Item 4—Information on the Company—Business Overview —Oil and Natural Gas Reserves."

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

	Net proved reserves at December 31,		Net proved reserves at December 31, 2006		
	2004	2005	Developed	Undeveloped	Total
Bohai Bay:					
Crude oil (mmbbls)	974.6	920.2	467.6	465.9	933.4
Natural gas (bcf)	706.2	740.7	299.9	465.1	765.0
Total (million BOE):	1,092.3	1,043.7	517.6	543.4	1,060.9
Independent (million BOE)	605.5	622.4	353.9	315.5	669.4
Production sharing contracts (million BOE)	486.8	421.3	163.7	227.9	391.5
Western South China Sea:					
Crude oil (mmbbls)	189.7	205.7	57.1	133.4	190.5
Natural gas (bcf)	2,484.8	2,604.0	1,529.1	1,119.0	2,648.1
Total (million BOE):	603.8	639.7	311.9	319.9	631.9
Independent (million BOE)	482.6	531.2	232.8	313.0	545.8
Production sharing contracts (million BOE)	121.2	108.5	79.1	6.9	86.0
Eastern South China Sea:					
Crude oil (mmbbls)	168.0	211.2	107.0	93.3	200.2
Natural gas (bcf)	730.8	784.2	37.3	754.7	792.0
Total (million BOE):	289.8	341.9	113.2	219.0	332.3
Independent (million BOE)	183.8	220.3	46.3	179.9	226.2
Production sharing contracts (million BOE)	106.0	121.6	67.0	39.1	106.1
East China Sea:					
Crude oil (mmbbls)	21.5	21.2	2.7	17.7	20.4
Natural gas (bcf)	403.4	402.2	60.8	329.2	390.0
Total (million BOE):	88.7	88.2	12.9	72.6	85.4
Independent (million BOE)	88.7	88.2	12.9	72.6	85.4
Production sharing contracts (million BOE)	—	—	—	—	—
Overseas:					
Crude oil (mmbbls)	101.9	99.1	81.9	63.3	145.3
Natural gas (bcf)	321.4	899.9	595.0	1,041.5	1,636.5
Total (million BOE):	155.5	249.1	181.1	236.9	418.0
Independent (million BOE)	—	—	—	—	—
Production sharing contracts (million BOE)	155.5	249.1	181.1	236.9	418.0
Total:					
Total crude oil (mmbbls)	1,455.6	1,457.4	716.3	773.6	1,489.8
Total natural gas (bcf)	4,646.6	5,430.9	2,522.1	3,709.5	6,231.6

Total (million BOE):	2,230.0	2,362.6	1,136.7	1,391.8	2,528.5
Independent (million BOE)	1,360.5	1,462.2	645.8	881.1	1,526.9
Production sharing contracts (million BOE)	869.5	900.4	490.9	510.7	1,001.6

Exploration and Production

Summary

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

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

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In addition, we hold several equity interests in oil and gas properties in foreign countries and regions, including Indonesia, Australia and Nigeria. See “Item 4—Information on the Company—Business Overview—Overseas Activity” and “Item 5—Operating and Financial Review and Prospects—Operating Results—Acquisitions and Overseas Activities.”

As of December 31, 2006, we had estimated net proved reserves of 2,528.5 million BOE, comprised of 1,489.8 million barrels of crude oil and condensate and 6,231.6 billion cubic feet of natural gas. As of December 31, 2006, we had interests in 45 producing properties and 53 properties under development offshore China. In 2006, 7 properties offshore China commenced production. For 2006, net production averaged 372,720 barrels per day of crude oil, condensate and natural gas liquids and 490.9 million cubic feet per day of natural gas, which together totaled 457,482 BOE per day, representing a 7.9% increase over the annual average daily production for 2005.

We conduct our exploration, development and production activities independently as well as through production sharing contracts with foreign partners. Production sharing contracts contain 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. In 2006, our controlling shareholder, CNOOC, signed nine production sharing contracts offshore China with foreign partners, most of which relate to area in the South China Sea. See “Item 4—Information on the Company—Business Overview—Production Sharing Contracts—Offshore China” for a detailed discussion of these arrangements.

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We also conduct exploration efforts through geophysical survey agreements with foreign companies. These geophysical survey agreements allow international oil and gas companies to make geophysical surveys and 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. We are currently party to one geophysical survey agreement. See “Item 4—Information on the Company—Business Overview—Geophysical Survey Agreements Offshore China” for a detailed discussion of these arrangements.

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 139 exploration blocks covering approximately 668,812 square kilometers. We have access to 913,290 kilometers of 2D seismic data and 51,928 square kilometers of 3D seismic data. From the beginning of CNOOC’s operations in 1982 to December 31, 2006, a total of 865 exploration wells have been drilled, including 557 wildcat wells, with a success rate of approximately 35%. During this period we achieved a success rate of approximately 42% on 262 independent exploration wildcat wells, while our foreign partners achieved a success rate of approximately 28% on their 295 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, 2006, approximately 55.0% 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.

Our “net proved reserves” consist of our percentage interest in reserves, including our 100% interest in the independent oil and gas properties and our participating interest in the properties covered under the production sharing contracts in PRC, less: (i) an adjustment for our share of royalties payable by us to the PRC government and our participating interest in share oil payable to the PRC government under the production sharing contracts, and (ii) an adjustment for production allocable to foreign partners under the PRC production sharing contracts as reimbursement for exploration expenses attributable to our particpating interest, and plus: (a) our participating interest in the properties in Australia and Nigeria and (b) the participating interest in the properties covered under the production sharing contracts in Indonesia less an adjustment for oil and gas distributed to the Indonesian government and the domestic market obligation.

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

At our request, Ryder Scott Company, an independent petroleum engineering consulting company, evaluated all our properties as of December 31, 2004, 2005 and 2006, except the reserves of OML130 project in Nigeria, which were evaluated by us. For further information regarding our reserves, see “Item 3—Key Information—Risk Factors—Risks relating to our business—The oil and gas reserves data in this annual report may require substantial revisions as a result of future drilling, testing and production.”

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

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Total Net Proved Crude Oil Reserves
(mmbbls)

	As of December 31,		As of December 31, 2006		
	2004	2005	Developed	Undeveloped	Total
Offshore China					
Independent					