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Sinopec Oilfield Service Corporation

(a joint stock limited company established in the People's Republic of China)

(Stock code: 1033)

Announcement on the Reply to the Letter of Inquiry after Review on the 2017 Annual Report of the Company by Shanghai Stock Exchange

The board of directors of the Company and all members of the Board warrant that there are no false representations, misleading statements and material omissions in this announcement, and are severally and jointly responsible for the authenticity, accuracy and completeness of the content herein.

This announcement is made by Sinopec Oilfield Service Corporation (the "Company") pursuant to Rule 13.10B of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

On 9 May 2018, Sinopec Oilfield Service Corporation (the " Company") received the "Inquiry Letter Regarding Post-vetting Comments on the 2017 Annual Report of Sinopec Oilfield Service Corporation" (《關於對中石化石油工程技術服務股份有限公司2017年年度報告的事後審核問詢函》) (Shang Zheng Gong Han 【2018】No.0468) from the Shanghai Stock Exchange (the "SSE"). According to the requirements of the SSE, the Company has carefully verified the relevant inquiries on an individual basis and hereby replies as follows:

1. Operating performance of the Company. According to the annual report, the net profit attributable to equity shareholders of the Company was approximately -RMB10.6 billion in 2017 as compared with the net profit attributable to equity shareholders of the Company of

-RMB16.1 billion in 2016. Meanwhile, while international oil price in 2017 rose slowly with average oil price of US$55/barrel during the year, the oilfield services industry showed a steady upward trend and the overall operating environment improved significantly compared to 2016. Please combine the international oil price trend, the industry conditions and the Company's production and operation status in 2017, explain and disclose the reasons for the continuous significant loss, and explain the reason and rationality why its operating performance has deviated significantly from the trend of oil prices considering the operating performance of comparable companies in the same industry during the year.

Reply:

In 2017, affected by certain factors such as OPEC's reduction in production and crude oil inventories, the crude oil market gradually stabilized. The average spot price of North Sea Brent crude oil in four quarters were US$ 53.67 /barrel, US$ 49.7 / barrel, US$ 52.1 / barrel, and US$ 61.17/ barrel, respectively, and the average spot price of North Sea Brent crude oil of the year was US$ 54.1 /barrel, representing an increase of 24.1% year-on-year. The rebound in international crude oil prices caused domestic and foreign oil companies to increase their capital expenditures on upstream exploration and development. As a result, the oilfield services industry showed a steady upward trend and the overall operating environment improved gradually. In 2017, due to the synchronous improvement of the oilfield services industry, the Company's workload in the major business segments all increased compared to 2016. However, since the recovery in the workload of the oilfield services industry lagged behind the increase in oil prices, the operating income of the Company increased by 13% year-on-year, lower than the average increase in the oil price of the year. In the same year, the loss in net profit attributable to equity shareholders of the Company decreased by RMB 5.5 billion over the same period of the previous year, resulting in a significant reduction in losses; the loss in net profit attributable to equity shareholders of the Company after deducting non-recurring gains and losses and impairment losses decreased by RMB 7.756 billion over the same period of the previous year. The main reasons for the Company's continued loss are as follows:

(1) The rebound in the oilfield market lagged behind oil prices, the total income was insufficient, and the gross profit of the main business was negative. In 2017, oil prices showed a steady upward trend after weak first and strong afterwards. Except for the North America, other oil-producing countries' capital expenditures on upstream exploration and development in the second half of the year grew slowly and the growth was mainly concentrated in the fourth quarter. In addition, the oilfield market itself reflects the industrial characteristics of the lagging oil prices. According to the oil field market report 2017, the international oil engineering market bottomed out in 2017, up 5% year-on-year. Affected by the delay of the market recovery, the growth in the

Company's revenue in 2017 was 11% lower than the increase in oil prices, and its revenue amounted to RMB 48.486 billion, which was lower than the break-even point of the Company and the gross profit of its main business was negative. As oil prices stabilized and picked up, in the first quarter of 2018, the Company signed new contracts valued RMB 12.5 billion, an increase of 197.6% year-on-year, and achieved an income of RMB10.267 billion, an increase of 16.48% year-on-year and the gross profit of the main business was positive.

(2) The relatively fixed total costs were high and the normal cost-reducing measures had little effect. In 2017, the Company had asset depreciation and amortization of RMB5.456 billion, labour cost of RMB14.257 billion, comprehensive resident services fees of RMB1.58 billion, totaling RMB21.293 billion, which was flat on a year-on-year basis and accounted for approximately 43.9% of the annual revenue. The total costs were relative fixed and could not be significantly reduced by using normal measures.

(3) The provision for impairment losses of RMB2.736 billion. In 2017, the Company put more efforts in the structural reforms of the supply side and implemented measures to reduce inefficient production capacity. The team size was downsized to 179 teams. The assets impairment of RMB1.221 million was made for the disposable equipment and auxiliaries. Moreover, due to the low international crude oil price, the prolonged collection of receivables and the financial difficulties of related parties, the Company made provision for bad debts of RMB1.27 billion under aging analysis method and individual recognition method and made provision for impairment of inventories of RMB245 million under construction contracts standards.

The business scope of the Company covers the full industrial-chain services in the oilfield service business. According to the size of assets and employee and business nature, the Company selects COSL in the domestic capital market and Schlumberger, Halliburton and Weatherford in the international capital market for comparison.

In 2017, the total operating revenue of COSL was RMB17.44 billion, representing an increase of 15% as compared with that in 2016, its net profit after extraordinary gain and loss attributable to the parent company was RMB-481 million, with losses reduced by RMB11.2 billion, its net profit after extraordinary gains and loss and impairments attributable to its parent company was RMB-393 million, with losses reduced by RMB3.0 billion. In 2017, Schlumberger, Halliburton and Weatherford recorded total operating revenue of USD30.44 billion, USD20.62 billion and USD5.699 billion, respectively, representing an year-on-year increase of 9%, 30% and -1%, respectively, and net profit attributable to the parent company of USD-1.505 billion, USD-463 million and USD-2.813 billion respectively, with losses reduced by USD182 million, USD5.3 billion and USD579 million as compared with that during the same period of last year, respectively. By comparison, the Company experienced an increase trend on its operating revenue in 2017 as compared with that during the same period of last year and recorded significant reduction of losses in respect of its net profit attributable to its parent company, with its performance comparable with the above four comparable peers.

2. Quarterly performance. As shown in the annual report, the operating income for the first to the fourth quarter of 2017 of the Company was RMB8.815 billion, RMB11.027 billion, RMB10.185 billion and RMB18.459 billion respectively, while the net profit attributable to

equity shareholders of the Company during the corresponding period was -RMB1.345 billion, - RMB0.940 billion, - RMB1.021 billion and -RMB7.277 billion respectively. The Company please further disclose the reason for its increased loss along with increased income in all quarters, especially the reason for the mismatch between operating income and net profit in the four quarters, and the impact thereof on its profitability and sustainability. The Company's accountant for annual audit please express opinions.

Reply:

The Company had net profit attributable to its parent company for the first quarter to the fourth quarter in 2017 of RMB-1.345 billion, RMB-940 million, RMB-1.021 billion and RMB-7.277 billion, respectively. The change on the gains and losses during each quarter was mainly due to the unbalanced workload and the management factors including employee performance assessment at the year end. In 2017, there was supply surplus in the oilfield service industry as a whole, no significant improvement was seen in the service price, the gross profit margin was still low, and the losses remained in the industry during the year. The Company had revenue of RMB8.815 billion for the first quarter, accounting for approximately 18.2% of the total revenue during the year, which was insufficient to effectively dilute the relatively fixed costs, thus resulted in a loss of RMB1.345 billion. The operating revenue for the second and third quarter increased by RMB2.212 billion and RMB1.369 billion as compared with that during the first quarter respectively, for which the revenue grew to over RMB10.00 billion, thus resulted in effective improvement on the dilution on fixed costs and the corresponding reduction in losses. The loss for the second quarter was lower than that for the third quarter, which resulted from that the revenue for the second quarter exceeded that for the third quarter by RMB842 million and there were government grants of RMB180 million including self-use consumption tax refund for the second quarter. During the fourth quarter, the losses further increased as performance-based salaries were paid all together and R&D expenses and repair expenses increased significantly, with the combined effect of various factors including the impairment loss from centralized disposal of assets at year end and the provision for the impairment loss of assets.

During the fourth quarter, according to the enterprise accounting standards and the Company's policy on provision for Impairment of assets , the Company made provision for assets impairment of RMB2.452 billion, of which provision for bad debts was RMB986 million, the provision for impairment of inventories was RMB317 million and provision for impairment loss of assets of RMB1.149 billion. Due to the centralized payment of performance-based salaries at the year end, the staff costs were RMB5.61 billion for the fourth quarter, representing an increase of RMB2.71 billion as compared with the average expenses for the previous three quarters. The general and administrative expenses for the fourth quarter increased by RMB1.048 billion than the average expenses for the previous three quarters, mainly due to the increase in repair expenses, R&D fees and destroyed inventories at the end of the year. In addition, the disposal of fixed assets resulted in loss on assets disposal of RMB136 million, representing an increase of RMB124 million as compared with the average loss for the previous three quarters, and the losses resulting from operating income and expenses and other gains

were approximately RMB3.42 million, representing an increase in the loss of RMB79.47 million as compared with the average gains of RMB76.05 million for the previous three quarters. Excluding the above factors, the loss for the fourth quarter was approximately RMB863 million, representing a decrease in loss of RMB239 million as compared with the average loss of RMB1.102 billion for the previous three quarters.

In 2018, it is generally predicted of major institutions that the international crude oil price will recover and oil companies will increase their capital expenditure for upstream exploration and development, for example, China Petroleum & Chemical Corporation, the largest customer of the Company, plans to expend RMB48.5 billion on its capital expenditure for upstream exploration and development, increased by RMB17.2 billion than its actual expenditure of RMB31.3 billion in last year. In the first quarter of 2018, the average prices of Brent crude oil was 66.9 USD/bbl, while the Company recorded operating revenue of RMB10.267 billion, representing a year-on-year increase of 16.48%, its gross profit margin for its principal business was 4.95%, a turnaround from negative to positive, representing a year-on-year increase of 9.34 percentage points, its net profit was RMB30.13 million, representing an increase of RMB1.375 billion as compared with that for the same period of last year, and its net profit after extraordinary gain and loss attributable to the parent company was RMB-335 million, representing an increase of RMB1.023 billion as compared with that for the same period of last year. In January 2018, the Company issued 1,526,717,556 A-shares and 3,314,961,482 H-shares by private placement respectively, raising funds at RMB7.638 billion in total, which enforces its liquidity, and its gearing ratio had dropped to 90.5% at the end of the first quarter. Early 2018, the Company obtained a line of credit of RMB12.3 billion and USD1.45 billion, and line of credit promissory note of RMB4.0 billion from China Petrochemical Corporation. The Company believes that its operating conditions will be gradually improved and its ability to operate on an on-going concern will be steadily enhanced.

3. Gross profit margin. According to the annual report, the principal activities of the Company, which are divided into geophysics, drilling engineering, logging and mud logging, special downhole operations, and engineering construction, etc., recorded improved gross profit margin as compared to 2016. However, except for geophysics which recorded gross profit margin of 5.6%, the gross profit margins of all other activities were in negative values, which were quite different from the gross profit margin of listed companies in the same industry. The Company please explain the reasons for the relatively low gross profit margin which were in negative values considering industry trends and the production and operation of the Company, and compare them with peers within the industry.

Reply:

In 2017, the Company's gross profit margin for its principal businesses including geophysical services, drilling business, downhole operation service and engineering and construction service was 5.64%, -7.23%,-13.98%, -7.94% and -5.55%, respectively, which was at low level, mainly due to the significant decrease in its revenue resulted from the increase in workload and service price in the oilfield service market since 2016 and little decrease in its relatively fixed costs. When compared with that for the same period of last year, the gross profit margin for its

principal businesses including geophysical services, drilling business, downhole operation service and engineering and construction service increase by 22, 21, 19,16 and 19 percentage points, respectively, all of which demonstrated the overall increase thereof. Due to the dependence of the Company's profitability on its revenue, with the growth in the oil price, the oilfield service industry and the workload, the gross profit margin for its principal businesses was rapidly improved when its revenue increased significantly. During the first quarter of 2018, the Company recorded an operating revenue of RMB10.267 billion, representing a year-on-year increase of 16.48%, and its gross profit margin for its principal business was 4.95%, a turnaround from negative to positive, representing a year-on-year increase of 9.34 percentage points.

In 207, it was seen from the peer company, COSL, that its revenue from geophysical and surveying services increased by 57.4%, with its gross profit margin being -7%, representing an increase of 44.5 percentage points as compared with last year, its revenue generated from drilling services increased by 2.9%, with its gross profit margin being 5.5%, representing an increase of 23.2 percentage points as compared with last year, and its revenue of well services increased by 17.8%, with its gross profit margin being 21.5%, representing an increase of 25 percentage points as compared with last year. The trend of improvement on gross profit from the principal businesses of the Company approximates that of COSL, for which the increase in gross profit margin of COSL in 2017 was higher than that of the Company.

4. Operating cost. As shown in the annual report, the operating cost and operating income of the Company were RMB50.976 billion and RMB48.486 billion respectively in 2017, while the operating cost and operating income of the Company were RMB53.517 billion and RMB 42.924 billion respectively in 2016, showing higher operating cost than operating income for two consecutive years. The Company please explain the reason and rationale for the abnormal income to cost ratios and the undue high operating cost. The Company's accountant for annual audit please express opinions.

Reply:

In 2016, the international crude oil price fell below USD30/bbl and has maintained in a slump with the average price of the year recording the lowest level in 12 years, and the average spot price of North Sea Brent crude oil of the year was only USD43.6/bbl. The operating revenue of the Company decreased by 28.9% on a year-on-year basis, which was due to that the low oil rice has caused domestic and international oil companies to substantially cut their capital expenditure on upstream exploration and development for two consecutive years in 2015 and 2016 by generally adopting measures of firstly reducing the unit price of oilfield service segment and then lowering the workload of oilfield service business, resulting in great impact on the oilfield service industry.

In 2017, international crude oil prices oscillated upward and rebounded, showed a trend of recovery after the weak first and strong after, The average spot price of North Sea Brent crude oil was US$54.1 per barrel, representing an increase of 24.1% year-on-year. The rebound in international crude oil prices has prompted domestic and foreign oil companies to increase

capital expenditures on upstream exploration and development. Except North America, capital expenditures for exploration and development in other upstream oil-producing countries have slow growth in the second half of the year, and the growth has been mainly concentrated in the fourth quarter. Accordingly, the oilfield service industry has shown a trend of stabilization and recovery since the fourth quarter, and the Company’s work volumes and operating income have stopped falling and began to increase in 2017.

The operating cost of the Company for two consecutive years are greater than its operating income, mainly due to the followings:

(1) The unit service price drops significantly, resulting in greater operating costs than operating revenue. In 2016, due to the drop in crude oil prices, oil companies cut the upstream exploration and development capital expenditures by reducing unit service price of oil service business. The service price of the Company in major markets decreased by 5%-15% year on year in 2016, while the cost was difficult to rapidly decline accordingly. In 2017, although the oil service market tends to improve, the price of oilfield service recorded no obvious increase as compared to 2016. Since 2016, the gross profit of the company has turned negative, and the operating cost has exceeded the operating income.

(2) The Company had high fixed cost expenses. In 2016 and 2017, the Company incurred significant depreciation and amortization, labor cost ,accounting for 34.4% and 36.6% of revenue respectively, which were relatively less affected by the revenue change, and of which, the asset depreciation and community integrated service fee were not affected by the revenue change.

(3) Sinopec Oil Engineering and Construction Corporation (hereafter referred to as “Engineering and Construction Corporation”), a wholly-owned subsidiary of the Company, experienced prolonged period, increased costs and compensation for variation lower than expectation in some construction projects, the result of which was relevant cost could not be offset by corresponding revenue.

5. Account receivables. According to the annual report, at the end of the period, the original value of accounts receivable of the Company was approximately RMB19.3 billion, a decrease of approximately 29% as compared with that at the beginning of the period, while the provision for bad debts was RMB2.3 billion, an increase of approximately 97% as compared with that at the beginning of the period. Among these, individually significant receivable but individual provision for bad and doubtful debts amounted to approximately RMB0.974 billion. It was disclosed in the note that such customer had difficulties in funding and there were no other channels for payment which had been overdue for three years and the Company made full provision for such account receivables, including the provision of RMB0.804 billion made during the year. In addition, the turnover days of Company's account receivables was approximately 152 days, a relatively long turnover period which was quite different from the average value within the same industry. The Company please provide additional disclosures on the following: (1) the reasons why the original value of account receivables decreased while the provision for bad debts increased significantly; the basis and rationale of making provision for bad debts, and whether the provision for bad debts in the previous period was sufficient; (2)

the name of the customer with, the reason for and the age of the large amount of bad debts; and the credit policy and collection measures of the Company; (3) disclosure of future management of and improvement measures for account receivables based on the Company's sales and collection policy. The Company's accountant for annual audit please express opinions.

Reply:

(1) The reasons why the original value of account receivables decreased while the provision for bad debts increased significantly; the basis and rationale of making provision for bad debts, and whether the provision for bad debts in the previous period was sufficient.

① The Company's policy on provision for bad and doubtful debts is set on in Note III (12) to the financial statements. Individually significant accounts receivable should be tested for impairment separately. The provision for bad and doubtful debts shall be made based on the difference between the present value of future cash flows and their carrying amount. Remaining receivables are categorized into aging group and related party group according to the credit risk combination and are tested for impairment separately.

② The carrying amount of the Company's accounts receivable at the beginning of the year was RMB25,080 million, and its carrying amount at the end of the year was RMB19,280 million, representing a decrease of approximately 23% as compared with that at the beginning of the year, of which accounts receivable due from related parties decreased 37.3% from RMB14,680 million at the beginning of the year to RMB9,200 million at the end of the year and that due from non-related parties decreased by 3.2% from RMB10,400 million at the beginning of the year to RMB10,080 million at the end of the year

③ According to the Company's policy on provision for bad and doubtful debts, the movement on balance of the Company's provision for bad and doubtful debts in 2017 was as follows (expressed in RMB thousand):

	31 December 2017	31 December 2016 年	Amount of increase
Related party group	-	-	-
Aging group	1,346,765	1,007,225	339,540
on an individual basis	973,982	169,948	804,034
Total	2,320,747	1,177,173	1,143,574

④ The reasons why the original value of account receivables decreased while the provision for bad debts increased significantly:

The decrease in the original value of account receivables was mainly due to to the fact that the original value of account receivables from related party group decreased by RMB5.47 billion as compared with that at the end of last year. The collection period of account receivables from such group was short. According to the future cash flow analysis, no impairment occurred.

The original value of account receivables for which the provision for bad debts made on an individual basis decreased by RMB60 million as compared with that at the end of last year was due to the impact of exchange rate changes. Due to the failure to recover the account receivables on time, difficulty in foreign exchange funds on individual customers which have no alternative payment channels and in light of the doubtful recovery of the account receivables in the future and increase in the risk of recovery, the impairment loss was provided in full in this year, resulting in an increase in bad debt provision of RMB804 million for the current period as compared to the beginning of the year.

The original value of account receivables for which the provision for bad debts made on the basis of aging group decreased by RMB270 million as compared with that at the end of last year, of which accounts receivable aging within 1 year decreased by RMB710 million; that aging over 1 years increased by RMB440 million, for which the provision for bad debts increased by RMB340 million due to delayed payment of certain customers as results of financial strain resulting from a decrease in the price of crude oil, of which accounts receivable aging from 1 to 2 years increased by RMB20 million, for which the provision for bad debts increased by RMB10 million; that aging from 2 to 3 years increased by RMB230 million, for which the provision for bad debts increased by RMB140 million; and that aging over 3 years increased by RMB190 million, for which the provision for bad debts increased by RMB190 million.

(2)The name of the customer with, the reason for and the age of the large amount of bad debts; and the credit policy and collection measures of the Company

① Accounts receivable with bad debt provision made on an individual basis is a portion of contract payments for a well workover service provided by a certain national oil company in Central Asia (hereinafter referred to as “Central Asian Company”) from 2010 to 2015. The Central Asian Company is the national oil company of the country and has more than 20 years of transaction records with our Company. In the prior years, it was able to make payment in time as agreed in the contract and has a high credit guarantee. From 2014 to 2016, due to the shortage of foreign exchange funds, The Central Asian company transferred the payment of the project through the transfer of creditor’s rights in the form of tripartite debt repayment. In 2017, disputes on oil and gas supply occurred between the country and the third-party country's customer. The original transaction was interrupted, resulting in the termination of the original payment channel and the inability to continue to make collection. Due to shortage of foreign exchange funds on the customers who have no alternative payment channels, the risk of payment recovery and the uncertainty increased. Therefore, bad debt provision was fully accrued in 2017.

② After termination of the original collection channel in 2017, our Company have despatched persons to communicate with ownner for several times to urge repayment. On the other hand, the local project department of the Company has collaborated with several Chinese enterprises with amounts owed, appointment the ambassador to China through the China Chamber of Commerce for the Import and Export of Machinery and Electronic Products, submit a letter requesting for assistance in the settlement of amounts outstanding; and request support from the National Energy Administration and the Ministry of Commerce to expand the collecting

approaches through multiple levels and channels.

（3）Management and improvement measures of account receivables of the Company in future.

In the future, the Company will continue to strengthen the management of account receivables. The first is to carry out market preliminary research and customer credit investigation, to manage customer credit rating, and to establish files of customer credit management, controlling the risk of capital collection from project source. The second is to seeking for increasing the transformation rate of inventory with focus on important points such as contract signing and milestone management, so as to implement responsibility and speed up settlement for constructions, shortening the time of transforming inventories into account receivables. The third is to strengthen credit period management of account receivables and establish risk prewarning and supervisory mechanism. For those account receivables due over the credit period, the Company will establish a three-level warning according to the overage, issue warning notice and execute special supervision over key units and major account receivables. The fourth is to establish responsibility implementing mechanism for collection of account receivables, accountability system for bad and doubtful debts and public listing for clearing mechanism, improving specific clearance. The fifth is to supervise key projects by requiring leaders to supervise major individual bad and doubtful debts on the basis of implementing collection by designated personnel and collection within stipulated period. The sixth is to enhance encashment of assessments, sign a collection responsibility letter to implement responsibility over project and project leader, implementing strict assessment and encashment to speed up capital return.

6. Inventories. As shown in the note in the annual report, the provision for amounts for project contracts due from customers among provision for decline in value of inventories increased by RMB0.245 billion during the current period, an increase which was significant as compared with the increase of approximately RMB11.66 million during the same period of the previous year. The Company please, considering the development trend as well as production and operation of the industry, provide additional disclosure of detailed breakdown of such amounts for project contracts due from customers, the main considerations for making provision for decline in value of inventories, the timing and basis of judgment of provision, and the reason for the dramatic increase in making provision for decline in value of inventories for the current period.

Reply:

The increase of RMB245 million in the estimated contractual loss in the provision for obsolete stocks of the Company for the current period represents the provision for the estimated contractual loss recognized in respect of the three road and bridge projects of Engineering and Construction Corporation, a wholly, a wholly-owned subsidiary of the Company, in South America, namely the San Buenaventura Road and Bridge Project, the YAPACANI-ICHILO

Road and Bridge Project and the SIBERIA-COMARAPA Road and Bridge Project based on the difference between the excess of total estimated contractual cost over total estimated contractual revenue and losses recognized in respect of these projects.

Since those three projects in South America commenced full construction in 2017, labor costs and prices of equipment and materials have been increasing which has resulted in deteriorating cost control. Moreover, due to slow release of right of road and prolonged construction period resulting in increase of costs, monopoly operation of local industry association resulting in increase in the usage costs of construction equipment, complex local relationship resulting in difficulty in tackling it, long rainy season cycle resulting in subgrade erosion and frequent repair together with low construction efficiency, the cumulative percentage of construction completed was only 39% as at the end of 2017. Upon calculation, the construction period is expected to delay by about two years and the costs are expected to increase significantly over those as originally estimated. As at the end of 2017, based on the costs incurred and comprehensive assessment of the volume of works not yet completed and upon calculation, the excess of total estimated contractual costs over total estimated contractual revenue is approximately RMB404 million equivalent. As at the end of 2017, the cumulative loss recognized amounted to RMB159 million and the provision for contractual loss of RMB245 million has been made based on the difference between the excess of total estimated contractual cost over total estimated contractual revenue and losses recognized in respect of these projects.
7. Fixed assets and construction in progress. According to the annual report, the Company's fixed assets for 2017 amounted to RMB25.583 billion, representing a decrease of approximately 11% as compare with the same period of the previous year. These included petroleum engineering special tools of RMB3.065 billion for which RMB1.149 billion of asset impairment provision was made during the current period while no impairment was made during the previous year. During the same period, the amount of construction in progress at the end of the period was RMB0.238 billion, a decrease of approximately 73% as compared with the same period of the previous year. The Company please provide additional disclosure of the basis and rationale for why the Company did not make provision for depreciation of its fixed assets in 2016 when the international oil services industry experienced downturn, but made provision for impairment in 2017 when the oil services industry experienced recovery; and the reasons for deviation from the industry. The Company's accountant for annual audit please express opinions.

Reply:

(1) Based on its judgment of the impact of future oil price trend on the oilfield services market and work volumes and on the fact that the impairment test conducted using the present value of future cash flows showed that there was no impairment in the asset groups, the Company did not make provision for fixed asset impairment when it conducted the fixed asset impairment test in 2016. In 2017, oil price rebounded and work volumes grew from last year. However, the oilfield services market still failed to experience a significant rebound and remained loss-making in that year. The oil price fluctuation trend and the Company's business performance

in 2017 are basically in line with the Company's pre-judgment made during the impairment test in 2016.

(2) International crude oil price entered into the upward channel in 2017. Domestic and overseas oil companies saw an increase in upstream exploitation and development capital expenses, work volumes of petroleum engineering increased to some extent in 2017 and the upstream exploitation and development capital expenses of oil companies are expected to continue to grow in 2018. The Company conducted an impairment test of asset groups which are normally reserved for utilization based on the present value of expected future cash flows and expected the recoverable amount to be higher than the carrying value. The test showed no impairment. Basic assumptions used in the Company's impairment test and the growth trend of work volumes in 2017 are basically the same as those in 2016.

(3) The fixed assets for which asset impairment provision were made in 2017 are the surplus equipment which the Company intends to dispose of as a part of its team cutdown. In order to improve its competitiveness and strongly deepen the supply-side structural reform, the Company implemented measures to eliminate inefficient production capacities in 2017. The Company determined the retainment size of each professional team based on the forecast work volumes of each segment for 2018-2019 and corresponding team retainment by cutting down 179 teams besides the retainment size and include the surplus equipment corresponding to the team cutdown in the Company's asset disposal plan. Due to the withdrawal of the team, this part of the fixed assets will be idle or disposed of for a relatively long period of time. The future cash inflows may be few and have greater uncertainty. There is no hard evidence to show the present value of the expected future cash flow of such assets significantly higher than the net amount of fair value minus disposal expenses, the company estimates the recoverable amount based on the net amount of the fair value of the assets minus the disposal expenses. The Company engaged independent third-party valuers to conduct asset impairment test and valuation on the surplus equipment to be disposed of in the team cutdown according to the market approach. According to the valuation report, the impairment provision for fixed assets amounted to RMB1.149 billion. The fixed asset scope corresponding to the asset impairment provision is different from the fixed assets normally used by the Company and the impairment valuation model have no corresponding relationship with the change trend of the oilfield services industry and work volumes.

8. Impairment loss on assets. According to the annual report, in 2017, the Company made provision for impairment loss on assets of RMB2.736 billion, a substantial increase of 263% as compared with RMB0.754 billion for the previous year, mainly due to excessive capacity, cancelled project teams, provision for impairment loss on spare assets, and provision for bad debts in 2017. (1) The Company please explain and disclose item by item the details of, reasons for and basis of the provision for impairment of assets, and the timing for indication of impairment of each item; (2) the Company please, based on the production and operation status, explain and disclose the reasons for the relatively big difference between the provisions for impairment on assets made in 2017 and 2016; (3) the Company please explain and disclose, in light of the industry developments and the trend of international crude oil price in 2016 and

2017, whether the provision for impairment on assets is reasonable. The Company's accountant for annual audit please express opinions.

Reply:

(1) The Company made a provision for asset impairment losses of RMB2,736 million for 2017, primarily as follows:

① provision for bad debts of RMB1,27 million.

The Company's policy on provision for bad debts is set out in Note III (12) to the financial statements. Individually significant accounts receivable should be taken impairment test separately. The provision for bad debts is recognized according to the difference between the present value of future cash flows, which is lower, and the carrying amount. Remaining receivables are categorized into aging group and related party group according to the credit risk combination and are tested for impairment separately.

Losses for bad debts of RMB804 million was recognized in respect of accounts receivable from the Central Asia Company in 2017. The provision of bad debts was due to the fact that the channel of recovery was closed due to its dispute with a third-party country, resulting in higher risks in payment collection, despite the recovery of such accounts receivable was smooth in the prior years. See the reply to Question 5 for details.

Accounts receivable provided for bad debts based on age group: provision of RMB466 million was made in respect of bad debts for 2017, due to an increase of RMB631 million in the original value of amounts receivable of more than 1 year for the year as compared to that at the end of last year.

② An amount of RMB72 million and RMB1,149 million was provided for in respect of impairment losses of inventories and fixed assets, respectively.

As set forth in the Reply 7(3), to enhance our competitive edges and vigorously deepen the supply-side structural reform, the Company implemented various measures to eliminate inefficient capacity and provided for redundant equipment to be disposed of arising as a result of team reduction in 2017. The Company made impairment test in accordance with CASBE 1 - "Inventories" and CASBE 8 - "Impairment of Assets" in December 2017, and the breakdown for provision of impairment based on the results of impairment test is set out below:

Category	Items	Provision for impairment (RMB ten thousand)
Fixed asset	Drilling rig	77,378
	Downhole operation equipment	14,540
	Logging and testing equipment	14,590
	Cementing auxiliary equipment	4,387
	Geophysical exploration equipment	543

	Other specialized equipment	3,511
	Subtotal	114,949
Inventory	Auxiliary materials for drilling	6,941
	Auxiliary materials for geophysical exploration	305
	Subtotal	7,246
Total		122,195

③An amount of RMB245 million was provided for estimated contract losses. Given that uncontrollable factors are emerging for the three road and bridge projects undertaken by the Engineering & Construction Co., a wholly-owned subsidiary of the Company, in South America, the Company made a second comprehensive assessment and measurement and identified the losses as expected. Accordingly, estimated contractual losses were provided for based on the standards for inventories. See the reply to Question 6 for details.

(2) Reasons for, and reasonableness of, the significant difference between the provisions made in 2017 and 2016 for impairment of assets.

In 2016, a provision of RMB754 million for the impairment of assets was made, mainly due to a provision of RMB727 million made on an individually identified basis for receivables due for one year or above and receivables overdue, a provision of RMB11 million for estimated contractual loss and a provision of RMB16 million for the impairment of the available-for-sale equity investments with consecutive losses.

As disclosed in 8.1(1), the Company made provisions of RMB1,27 million in 2017 for the bad debts of receivables in accordance with its policies on the provision for bad debts, representing an increase of RMB543million as compared to the previous year, which was mainly a result of an increase in the provisions for bad debts due to the increase of RMB631 million in the original value of receivables due for one year or above as compared to that as at the end of the previous year and an increase of RMB804 million in the full provisions for bad debts due to increased risks relating to the collection of individually identified receivables due to the disruption of collection channels and the lack of alternative collection channels.

As disclosed in 8.1(2), due to the measures implemented in 2017 for eliminating inefficient capacity, a provision of RMB72 million was made for the devaluation loss of inventory and an impairment loss of fixed assets of RMB1,149 million was recorded in 2017, while no such items occurred in the previous year. The provision for the impairment loss of fixed assets was in compliance with the requirements of Accounting Standards for Business Enterprises No. 8 – Impairment of Assets.

As disclosed in 8.1(3), the Company made a provision of RMB245 million in 2017 for the

estimated contractual loss of the three bridge and road projects in South America based on the difference between the excess of estimated total contractual costs over estimated total contractual income and recognized contractual loss, as compared to the provisions of RMB11 million in 2016 for the estimated contractual loss of other projects, representing an increase of RMB234 million. The estimated contractual loss was incurred by different projects at different stages and the provisions for such estimated contractual loss were in compliance with the requirements of Article 27 of Accounting Standards for Business Enterprises No. 15 – Construction Contracts.

9. Non-current assets due within one year and long-term deferred expenses. As shown in the 2016 annual report, non-current assets due within one year and long-term deferred expenses of the Company amounted to RMB1.011 billion and RMB3.072 billion respectively, while in the 2017 annual report the non-current assets due within one year at the beginning of the period and long-term deferred expenses amounted to zero and RMB4.083 billion respectively. The Company please verify whether there are retrospective adjustments to or restatements for circumstances such as correction of accounting errors, and explain the reasons for inconsistency of data of the two items in the two financial statements.

Reply:

(1) According to the application guidelines for "Accounting Standards for Business Enterprises No. 30 - Presentation of Financial Statements" published by the Ministry of Finance, the column of " long-term deferred expenses " shall be filled in as the amount after deducting the amortized amount within one year (inclusive of one year) from the closing balance of the " long-term deferred expenses ". According to the application guidelines, the Company shall include the long-term deferred expenses that are expected to be amortized within one year (inclusive of one year) into “non-current assets due within one year” before 2017.

(2) The Accounting Department of the Ministry of Finance published the interpretation on the “Announcement of the revision of general enterprises financial statement format (Cai Kuai [2017] No. 30) on 12 January 2018, pursuant to which, non-current assets such as fixed assets, intangible assets, and long-term deferred expenses subsequently measured by adopting the depreciation (or amortization, depletion) methods in accordance with the relevant accounting standards, whose life (or period) of depreciation (or amortization, depletion) is only one year or less than one year is not necessarily classified as current assets and still presented in the column of non-current assets and not included in the column of “non-current assets due within one year”. It is expected that the part to be depreciated (or amortized or depleted) within one year (inclusive of one year) is not necessarily classified as current assets and not included in the column of “non-current assets due within one year”. According to the interpretation, when the Company prepares the 2017 financial statements, the long-term deferred expenses due or amortized within one year will no longer be presented separately in the “non-current assets due within one year” and will be included in the “long-term deferred expenses”, and the comparative data will be adjusted.

The adjustment to the presentation of the above statements by the Company is made in accordance with the relevant requirements of the Ministry of Finance which complies with the relevant provisions of the Accounting Standards for Business Enterprises. Therefore, such adjustment is not a correction of accounting errors.

10. Intangible assets. The Company's intangible assets for 2017 amounted to RMB0.282 billion, an increase of 52% over the same period of the previous year, which was mainly due to the growth in contract revenue right. As shown in the annual report, future revenue right was due to the investment in overseas oilfield comprehensive services projects during the year. The amount of contract revenue right was RMB23.196 million at the beginning of the period as compared with RMB116 million at the end of the period, representing an increase of 400%. The Company please explain, considering own future plans, business development conditions, industry trends, etc., specific contents of the contractual revenue right relating to overseas projects, as well as the feasibility, future profit forecast and the basis for large-sum of investment in such intangible assets under condition of ongoing loss of the Company.

Reply:

In 2017, the contract revenue right included into intangible assets by the Company was calculated based on the comprehensive service projects of three old oilfields of PAM, a Ecuadorian national oil company, for optimizing production capacity and enhancing oil recovery efficiency. The contract came into effect from 1 January 2015 with a contract period of 15+5 years. The contract is to provide oilfield geological research, geophysical exploration, drilling and completion service, oil production and management as well as oilfield surface engineering construction and other comprehensive services for the three old oilfields in eastern Ecuador, and the Company obtained part of the cost and profit from the increased oil production according to the contract. At the end of 2017, the contract revenue right under intangible assets showed the balance of the investment expenditures of the new wells and measure wells that have been put into operation, net of amortization.

As of the end of 2017, according to the contract, the Company has invested a total of RMB219 million, of which RMB5 million was made in 2017, and they were listed under “construction projects” and “intangible assets”, respectively. In 2017, due to the transfer of seven new wells and measure wells, investment expenditures for related operations were transferred from “construction-in-progress” to “intangible assets”, resulting in a substantial increase in intangible assets in 2017.

The comprehensive oilfield service model has the advantages of easy management, risk control, and cost reduction for the owner. For the purpose of the Company, it is beneficial to exert its full coverage advantage in the oil service industry chain, achieve differentiated market positioning and create synergy effects, thus obtaining higher profit.

In 2017, as some new wells and measure wells were put into production and transferred, the project realized a profit of USD1.59 million in 2017. The remaining contract period of the oilfield comprehensive service project is 12 years. According to the preliminary estimate, during the remaining contract life cycle, the total income would be USD245 million, and the total expenditure would be USD161 million. Based on the discount rate of 10% and the oil

price in the next 12 years, it is estimated that the net present value of the contract would be USD19 million with an internal rate of return on investment of 16%.

By Order of the Board

Mr. Li Honghai

Company Secretary

Beijing, PRC, 16 May 2018

As at the date of this announcement, the Board of Directors comprises Mr. Jiao Fangzheng+, Mr. Sun Qingde#, Mr. Chen Xikun#, Mr.Ye Guohua+, Mr.Lu Baoping+, Mr.Fan Zhonghai+, Ms. Jiang Bo, Mr. Zhang Huaqiao* and Mr. Pan Ying*.*

" + " Non-Executive Director

" # " Executive Director

*" * " Independent Non-Executive Director*