

# Management's Discussion and Analysis Report

## OIL AND GAS INDUSTRY OUTLOOK AND OPPORTUNITIES

One of history's Black Swan event the coronavirus pandemic that spread around the world during Jan- Mar this year continues to this day. While no industry has been spared the effects of this pandemic, the Oil & Gas industry, arguably, has been one of the worst hit due to sharp decline in demand and crash in prices. Even if uncertainty still remains, oil, like many a time before has proven to be resilient and prices have risen up to the range of \$40-\$45 since then.

This would prove to be a transformational moment for Oil & Gas because oil prices were stressed, even before the pandemic, on account of disagreement between oil producing countries resulting in a supply shock. Dual supply & demand pressures are therefore pushing Oil & Gas companies toward discipline in finance, prudent capital allocation, risk management & environmental Governance. For E&P companies, in particular, it would mean achieving the same level of performance more cost effectively and re-imagining the operating model towards greater efficiency.

For India, the disruption of supply chains due to the pandemic, has pushed the Govt. to focus its policy initiatives toward a 'Atmanirbhar Bharat'. This applies to the Oil & Gas industry as well, where the Govt. further strengthened its commitment toward reducing oil import dependence. After implementing progressive Initiatives like the National Data Repository (NDR), Open Acreage Licensing Policy (OALP) & Hydrocarbon Exploration and Licensing Policy (HELP), the Govt. is now putting its efforts toward a market driven pricing mechanism for Natural Gas. The Indian Gas Exchange (IGX) was inaugurated on 15<sup>th</sup> June 2020 which forms an important milestone in freeing up the domestic natural gas market.

These policies include some very welcome changes. The move to a revenue sharing regime, rationalization of royalty and cess, full pricing and marketing freedom for oil & gas, ability to quickly identify areas of interest, bid and secure them are noteworthy. Even in the turbulent times globally, the oil & gas sector in India, is opening up. Demand for domestically produced oil remains intact as there is a captive market for the oil & gas produced in India.

HOEC, with its focus on low-cost operations, prudent capital management, diverse asset portfolio and proven capabilities in execution is well-positioned to weather this storm by enhancing its oil production from its block B-80 in Western Offshore and by leveraging the opportunities from the transition and push toward a gas-based economy.

### Global Oil Price

Crude Oil Prices (Brent) decreased from US\$ 71 per barrel in April 2019 to US\$ 32 per barrel in March 2020.

### Indian Gas Price

The price for domestic natural gas (derived from a cocktail of gas prices prevailing in multiple global gas markets) issued by the Petroleum Planning & Analysis Cell (PPAC), Ministry of Petroleum & Natural Gas (MoP&NG), Government of India has decreased from US\$ 3.69/MMBTU during April 2019 - September 2019 to US\$ 3.23/MMBTU during October 2019 - March 2020.

### HOEC VISION

HOEC is India's first private E&P company and has decades of experience operating multiple fields, both onshore and offshore in leading producing basins. Energy security being a strategic priority for the country, HOEC's business is, therefore, linked with the National Priority. We will work closely with all stakeholders to explore, develop and produce hydrocarbons in a safe and responsible manner.

Our passion is to find, develop and deliver oil & gas that everybody in our country needs. We believe talent and technology are the key ingredients to building and sustaining a successful E & P business.

Our vision is to establish and transform 'Resources' to 'Assets' to create value for all stakeholders and Grow Responsibly. We seek to realize our vision by;

- Exploring for Oil & Gas;
- Executing to transform Resources to Reserves; and
- Enhancing value for all stakeholders by converting Reserves to Revenues.

### **HOEC Business Strategy and Values**

HOEC's strategy is focused on delivering growth in the Company's core business, while enhancing profitability through:

- Establishing and sustaining low cost operations in all our assets
- Identifying and developing low risk, short cycle projects for rapidly increasing production
- Improve value maximization by increasing realised price & by increasing production through optimising existing facilities

Our near-term focus is to secure the best possible value from the excellent set of opportunities presented by our portfolio of discovered resources along with prudent capital allocation and carefully planned market strategies.

### **Values of HOEC**

<b>Honesty</b>	We believe in honesty and are committed to conduct our business ethically and transparently.
<b>Ownership</b>	We are One Team and hold ourselves personally accountable for our decisions, actions, attitudes and results.
<b>Entrepreneurship</b>	We are entrepreneurs at heart and are passionate about adding value to make a difference to all our stakeholders.
<b>Care</b>	We care for each other, the communities and the environment in which we operate.

HOEC believes that securing and maintaining the social licence to operate through good environmental, social, health and safe performance is an integral part of our business success.

Our commitment to these principles is demonstrated by the fact that we have had no lost-time accidents or environmental incidents during the year under review.

We conduct our business with respect and care for our communities and the environment in which we operate. We will be a good corporate citizen of India, and will maximise utilization of local talent, services, and equipment.

To sum up, HOEC business strategy is to continue to invest in low risk and short cycle projects & to remain focused on innovative management of cost and speed of execution to create value to all stakeholders and Grow Responsibly.

Some operational highlights of FY 2019-20 to deliver the Strategy, guided by our Values are summarized below:

- Sourced men & material from across the world and managed local logistics to complete the two-well drilling campaign in Mumbai offshore.
- Conversion of MOPU is now completed and it is ready to sail-out from the Middle East. FSO is procured and is undergoing maintenance activities. Testing from both wells in B-80 has established a production potential of > 8000 boepd.

- Dirok continued its 3<sup>rd</sup> successful year of commercial production, safe and reliable operations.
- PSC extension of PY-1 and Kharsang was reviewed and recommended by the Management Committee.
- We continued operations in our operational blocks and maintained production during majority period of the prevailing lockdown safely.

## OPERATIONAL AND FINANCIAL DISCIPLINE

Oil & Gas exploration is a capital-intensive industry with associated risks. The financial strategy of the Company is focused on monetising the existing assets and bringing value to the stakeholders. Accordingly, our near-term focus is to bring the B-80 field to production, execute the revised field development plan in Assam, improve production from PY-1 and increase the value of other assets in our portfolio of discovered resources.

### Corporate Responsibility

<b>Safety First</b>	Never put any person or asset in an un-safe situation.
<b>Environment Friendly</b>	Not to harm the environment.
<b>Regulation Compliant</b>	Compliant with applicable laws all the time.
<b>Optimum Cost (US\$/bbl)</b>	Complete the development in a cost and time effective manner.
<b>Investment Prudence</b>	Not to take risk beyond the means and to prioritize the opportunities in our portfolio on risked expected monetary value in any given year.

In pursuit of its business strategy, all projects are screened on a rigorous, consistent basis for technical and commercial viability. We use our in-house geoscience expertise and third-party independent experts to identify, evaluate and prioritize the opportunities.

As an Optimum Cost Operator in the industry, we scrutinize every value proposition to derive excellence in execution. Cost is considered an element to control when it does not result in value sacrifice in the E&P business.

Our objective is to provide a consistent compounded annual growth rate to our shareholders, commensurate to the risks in this business.

### Operations Overview

The Company's activities relate to exploration, development and production (based on exploration success) of hydrocarbons (crude oil and natural gas), which are natural resources. HOEC assets are geographically spread across Tamil Nadu, Maharashtra, Gujarat, Assam and Arunachal Pradesh (both offshore and onshore) with a balanced portfolio of development and production assets, both in onshore and offshore.

### Product-wise Performance

The Company's aggregate production during the FY 2019-20 was 1.10 million barrels of oil equivalent (MMBOE) (Crude oil: 0.10 million barrels; Gas: 5.25 BCF) as against 1.43 million barrels of oil equivalent (MMBOE) (Crude oil: 0.14 million barrels; Gas: 6.98 BCF) during the previous year. This decrease in production is mainly due to certain consumer shutdowns and resulting reduced production capacity from PY-1, resulting in lower gas offtake levels at Dirok field in Assam and PY-1 field.

### Reserves

As of March 31, 2020, the in-house estimates of Proved and Probable (P+P) reserves on working interest basis for the Company were 26.65 MMBOE.

## RISKS, THREATS, UNCERTAINTIES AND CONCERNS

HOEC's business, financial standing and reputation may be impacted by various risks and uncertainties, not all of which are within its control. Company identifies and monitors the key risks and uncertainties affecting our operations and runs the business in a way that minimizes their impact where possible.

The Company's level of risk and its management approach is discussed and reviewed by the Board, Audit Committee and Senior Management. The principal risks and uncertainties facing the Company and the actions taken to mitigate these risks are as follows:

### Strategic and Operational Risk

Description of Risk	Mitigation
Business Model	Our Board Members along with Management team periodically reviews the Company's business model and effect necessary adjustments if economic circumstances so demand. The Board has constituted a Risk Management Committee under the chairmanship of Mr. Pronip Kumar Borthakur, a Non-Executive Independent Director (former Director Offshore, ONGC).
Portfolio Mix	The Company maintains a diverse portfolio of oil and gas assets across a range of sedimentary basins and at different project life cycles to minimize exposure to geographical, geological and commodity market risk.
Health, Safety and Environment	Oil and gas operations by its very nature carry a potentially high level of attendant safety and environmental risks and the impact of an accident can be significant in terms of human, environmental and financial cost. HOEC carries out HAZOP, HAZID, SIMOPS and maintains risk register and Emergency Response Plan covering risks specific to various operations. The Company has devised a comprehensive policy framework as well as health and safety management and reporting systems. These are regularly monitored and reviewed by the Board and the Management. The Company also works closely with various regulatory authorities of the Central and State Governments and compliance audits are conducted. To mitigate disruptions in production and other losses due to coronavirus, protocols and SoPs like mandatory wearing of masks, temperature checks, social distancing and other hygiene practises are in place and are adhered to strictly. The Company undertakes operations as per international environmental standards of the Oil Industry. Environmental Impact Assessments are prepared and approvals from authorities are secured before any project is executed.
Exploration Geological and Reservoir Risk	Exploration is inherently a risky business, with statistically only a relatively small proportion of exploration wells resulting in commercial discovery. Systematic geo-scientific workflow is pursued under internal technical stewardship and peer reviewed by third party experts to minimise geological and reservoir risks and maximize opportunities. HOEC has now set up a Technical Advisory Committee (TAC) with seven domain experts.
Reserves Estimation and Recovery Risk	Numerous uncertainties are inherent in estimating crude oil and natural gas reserves. Reservoir engineering follows a subjective process of estimating underground accumulations of crude oil and natural gas. It is well recognized that these cannot be measured in an exact manner. Reserves estimations involve a high degree of technical judgment and it is a function of the quality of the available geological and reservoir data. Results of drilling, testing and production may substantially change the reserve estimates for a given reservoir over a period of time. For these reasons, actual recoverable reserves may vary substantially from original estimates.
Community Relationship	Continuous dialogue and engagement exist between the Company and its stakeholders, which is central to harmonious operations. A robust local content policy has been announced and being implemented. Local personnel are employed wherever possible and Company helps in developing skill sets of such personnel.

### Financial Risk

Description of Risk	Mitigation
Commodity Price Volatility	HOEC is exposed to volatility in the oil and gas prices since the Company does not undertake any oil price hedge. The impact of a falling oil price is however partly mitigated via the production sharing formula in the PSCs, whereby our share of gross production increases in a falling oil price environment due to cost recovery mechanism. Gas prices are fixed for certain duration and the same are based on policy guidelines issued by the Government.
Foreign Exchange Exposure and Interest Rate Risk	Company enjoys a natural hedge to a certain extent as its receivable and significant expenditure are denominated in United States Dollar (US\$).
Cost Inflation impacting both Goods and Services	The Company pursues structured planning processes which allow sufficient time for procurement of services and tracking the critical path activities. Company maintains past procurement cost data and constantly monitors changes in market.

**Compliance, Ethical and Governance Risk**

Description of Risk	Mitigation
Legal, Regulatory and Litigation	The Company's activities are subject to various laws and regulations. Regulatory changes may impact the value of the Company. Risks are mitigated by proactive assessment and ensuring compliance. The Company is party to various ongoing litigations, which if decided against the Company, may have an adverse impact on the financial position of the Company.
Ethical Conduct	The Company recognizes the importance and maintains transparent and responsible relationships with all its stakeholders and has a robust Whistle Blower Policy wherein the employees have a direct access to the Chairman of the Board.
Corporate Governance	The Company recognizes the importance of maintaining strong corporate governance procedures and processes. The Company has a robust governance framework in place. The Board reviews compliance with the applicable regulatory guidelines and best practices.

**Insurance Coverage**

Our business is subject to the operating risks. As protection against financial loss resulting from some of the operating hazards, we maintain insurance coverage for all operated and non-operated assets, including physical damage, control of well, seepage and pollution and employer's liability, third party liability, goods in transit, coverage for assets and comprehensive general liability insurance.

The coverage is subject to customary deductibles, waiting periods and recovery limits. We maintain insurance at levels that we believe are appropriate and consistent with industry practice and we regularly review our potential risks of loss and the cost and availability of insurance and revise our insurance program accordingly. The Company also procures director's liability insurance covering the cost of legal representation and crisis management.

**FINANCIAL REVIEW**

The revenue for the current year has declined to ₹ 17,983.54 lakhs from ₹ 23,689.41 lakhs in the previous year. This decrease is primarily for reasons as detailed in the section 'Operational and Financial Discipline' of the Management's Discussion & Analysis Report.

The Company's production on working interest basis during the year is 11,00,293 boe (3,006 boepd) and for the previous year was 14,26,872 boe (3,909 boepd) which is 23% lower than the previous year.

Other income for the current year stands at ₹ 2,157.73 lakhs as against ₹ 1,006.32 lakhs in the previous year, which includes interest income and income from financial investments.

The average price realised on sale of crude oil for current financial year is US\$ 53.82/bbl and for gas is US\$ 3.82 per mmbtu against US\$ 63.27/bbl for crude oil and US\$ 3.62 per mmbtu for gas in the previous year.

**Operating Costs**

During the year, the cost towards production expenses has reduced to ₹ 2,599.54 lakhs compared to ₹ 2,823 lakhs in the previous year. Other expenses have reduced to ₹ 599.79 lakhs from ₹ 711.13 lakhs in the current year.

**Finance Costs**

The Company has not incurred any interest or finance cost during the financial year 2019-20 except the impact of unwinding the decommissioning cost.

**Net Profit/Loss**

On a standalone basis, the Profit-After-Tax is ₹ 14,083.39 lakhs as against the profit of ₹ 14,896.46 lakhs in the previous year.

**Cash Flow**

The Operating profit before exceptional items and tax is ₹ 11,461.90 lakhs in the current financial year against ₹ 14,758.75 lakhs in the previous year. Operating profit before the working capital changes is ₹ 12,668.05 lakhs in the current financial year and for the previous year was ₹ 17,709.59 lakhs. The exceptional item for the current year is ₹ 2,621.49 lakhs and for the previous year was ₹ 230.69 lakhs. The net increase in cash and cash equivalents during the financial year is ₹ 1,190.48 lakhs. The effective cash and cash equivalents of the Company at the end of the financial year is ₹ 14,059.59 lakhs as against ₹ 12,869.11 lakhs in the previous year.

**Ratio Analysis**

The details of significant changes (i.e. changes of 25% or more) in key financial ratios, along with the explanations therefor, are as follows:

Ratio	Level change
Debtors Turnover	4.68 times
Inventory Turnover	4.08 times
Return on Net worth	21%

**Companies (Indian Accounting Standards) Rules, 2015**

In accordance with the Companies (Indian Accounting Standards), Rules 2015 of the Companies Act, 2013, HOEC has followed the Indian Accounting Standards (Ind AS) for preparation of its financial statements.

**Critical Accounting Policies and Estimates**

The preparation of the financial statements requires the Company's management to make several estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. When alternatives exist among various accounting methods, the choice of accounting method can have a significant impact on reported amounts. The following is a discussion of the accounting policies, estimates and judgment which management believes are most significant in the preparation of the financial statements.

**Oil and Gas Properties**

We account for crude oil and natural gas properties under the Successful Efforts Method (SEM) of accounting. Under the SEM, costs to acquire mineral interests in crude oil and natural gas properties, to drill and equip exploratory wells that find commercial quantities of proved reserves, and to drill and equip development wells are capitalized. Proved property acquisition costs are amortized by the unit of production method on a field-by-field basis, based on total proved developed crude oil and natural gas reserves, as approved by the Management Committees of the respective Unincorporated Joint Ventures. Costs associated with drilling successful exploratory wells and drilling development wells are amortized by the unit of production method on a field-by-field basis. These costs, along with support equipment and facilities, are amortized based on proved developed crude oil and natural gas reserves. Survey and seismic acquisition costs are expensed.

Besides being the recommended method under the Guidance Note issued by the Institute of Chartered Accountants of India, we believe that the SEM is the most appropriate method to use in accounting for our crude oil and natural gas properties because it provides a better representation of results of operations for a Company of our size.

**Site Restoration Liability**

Our site restoration liability consists of estimated costs of dismantling and abandoning producing well sites and facilities, site reclamation and similar activities associated with our oil and gas properties. The recognition of Site Restoration Liability requires that management make estimates, assumptions and judgments regarding such factors as estimated probabilities, amounts and timings of obligation. The corresponding amount is added to the cost of the producing property and is expensed in proportion to the production for the year and the remaining estimated proved reserves of hydrocarbons based on latest technical assessment available with the Company. Any change in the value of the estimated liability is dealt with prospectively and reflected as an adjustment to the provision and the corresponding producing property.

**FINANCIAL POSITION****Liquidity**

At the year end, HOEC had cash and cash equivalent of ₹ 14,059.59 lakhs. Cash surplus is placed in debt oriented liquid funds and bank deposits as approved by the Board. HOEC manages its short-term liquidity to generate returns by investing its surplus funds, while ensuring safety of capital.

**Capital Requirements**

The Company has adequate cash in hand, working capital and internal accruals to implement its business plan to drive organic growth of its portfolio. The Board recognizes that the Company has a successful track record of raising capital in the past and that the Company shall raise financial resources as and when needed to meet any new growth opportunities.

**OUTLOOK**

Based on our business plan to convert the discovered resources in our portfolio of assets, our outlook remains positive.

**INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY**

The Company maintains a comprehensive system of internal control. This comprises the management systems, organizational structures, processes and standards that are implemented to conduct our business operations. The Company has a proper and adequate system of internal control commensurate with the size and nature of business. These systems provide a reasonable assurance in respect of providing financial and operational information, complying with applicable statutes, safeguarding of assets of the Company and ensuring compliance with corporate policies.

The Company also conducts periodic evaluations, mainly through its Internal Audit, to determine the adequacy of its Internal Controls System.

The Company has appointed M/s Guru & Ram LLP, an independent firm with expertise in internal audit and assurance, which inter-alia ensures the adequacy of the procedures of recognizing and managing risks applied by the Management, the effectiveness of the Internal Controls System and the quality and reliability of the information given to the Management with regards to the System of Internal Controls. The adequacy of the Internal Controls System is monitored on a systematic basis by the Audit Committee, through reports submitted to it by the Internal Auditors. Reports by the Management and the Internal Auditors include assessments of the major risks and the effectiveness of the Internal Controls System in addressing them.

Systemic weaknesses identified, if any, are incorporated in the reports, including the impact they had or could have had, as well as the actions of Management to correct them. No significant control failures were reported during the year.

As part of the Company's internal control process, any transactions with related parties are approved by the Audit Committee and Board of Directors, and appropriately disclosed in the financial statements.

The Company's Information Technology (IT) Department provides the required tools and solutions to all employees and manage the operations and support of IT systems and applications efficiently using internal and external resources.

The Company has internal controls regarding fixed assets, inventories, cash and bank checks, etc., such as physical security, inventory counts and reconciliations of physically counted quantities with the recorded ones. Further, the Company has schedule of quarterly inventory counts to confirm inventory levels as per accounting records. The Company also has a delegated authorities and responsibilities, which depicts assigned authorities to various Company executives, to conduct certain transactions or actions (e.g. payments, receipts, contracts, etc.).

## WHISTLE-BLOWER POLICY

The Company has a whistle-blower policy in place. A copy of the policy has been made available on the website of the Company at <https://www.hoec.com/grow-with-us/corporate-governance/>. All employees, contractual persons, consultants, vendors and customers of HOEC can raise concerns about possible wrongdoing by contacting the Ombudsperson (Chairman - HOEC Board) in a confidential manner.

## TALENT DEVELOPMENT

Oil & Gas discoveries around the world happen because of talented people supported by technology. HOEC is committed to provide a robust platform for talented people to develop ideas, work as a team to create value and make a difference to all the stakeholders. Our ability to create sustainable stakeholder value is linked with our ability to recruit, motivate and retain top talent. Accordingly, technical talent pool is being strengthened continuously both by engaging experienced experts on full and part time basis in Technical Advisory Committee (TAC) and by inducting young talent.

HOEC strives to ensure a caring and energised work environment, where employee engagement is high. This is sought to be achieved by empowering employees and encouraging innovation and ownership. Being a small team helps in seamless communication, where relationships amongst our employees are cohesive and team spirit is high.

HOEC values all employees for their contribution to our business. We are committed to develop and deploy people with the skills, capability and determination required to meet our business objectives. Opportunities for advancement are equal and not influenced by considerations other than performance and aptitude. Employees are motivated to develop within a flexible framework and are encouraged to provide feedback on their expectations.

## HEALTH, SAFETY, ENVIRONMENT & SOCIAL RESPONSIBILITY

We believe that "All Lives Have Equal Value" and nothing that we do can be more important than ensuring safety. We are committed to making a positive contribution to the protection of the environment in areas in which we operate and to do everything possible to minimize any adverse effects of our operations.

A series of reports are generated on a regular basis to monitor compliance with standards on gas emissions, liquid effluents, solid waste, noise and incident statistics monitoring. These reports are then collated and used to highlight and propose an action plan for any area of non-compliance or where there is potential for improvement. Emergency Response Plan (ERP) is also in place for operational areas.

HOEC continued to maintain a sound health and safety record in FY 2019-2020. As always, special skills training on Job Safety Awareness (JSA) and Risk Assessment and several HSE awareness campaigns have been conducted in our operating sites in Assam and best practices have been felicitated by HSE Awards Program.

The Key Performance Indicators (KPIs) related to HSE are as below:

KPIs statistics	FY 2019-20	FY 2018-19
Fatalities Accident Rate (FAR)	0	0
No. of LTIs	0	0
Days since last LTI	1,209	844
Oil Spill Incidents	0	0
Fatal Accident Rate	0	0
LTI Frequency	0.01	0.01
LTI Severity	0	0

### Corporate Social Responsibility

HOEC believes that its License to Operate is to be earned from the local community in the area of its operations and it is keen to leave a positive economic and social impact through its operations and make a difference to the quality of life of its local stakeholders. Promoting local content in all our operations is at the core of our CSR policy and accordingly, Company has rolled-out a local content policy for our North East Operations.

#### Our CSR Policy and Programmes seek to:

- Promote local content by developing entrepreneurship and local enterprises
- Improve access to clean drinking water
- Enhance the quality of education in our operating area
- Promote personal safety, environmental and technology awareness
- Support promotion of local culture and sports

### KEY STRENGTHS OF HOEC

#### Quality Asset Portfolio

- Portfolio of discovered resources - all blocks with discoveries producing or ready to be developed
- Diverse geographical footprint - Presence in 4 out of 7 producing basins in India
- Balanced portfolio - Offshore/Onshore & Oil / Gas
- Upside potential for exploration within portfolio with infrastructure for rapid monetisation
- Operatorship in majority of blocks to drive value creation

#### Strong Organization

- India's first private E&P company with decades of experience operating onshore and offshore fields
- Professional management with proven industry experience
- Delivered leading HSE performance with strong focus on safe and sustainable operations
- Superior technical capability across the E&P value chain
- Proven experience in fast track development and low-cost operations, both on-shore and off-shore
- Recognised as a partner of choice to develop and maintain social and regulatory license to operate

#### **Note:**

*In preceding sections of this Annual Report, in particular the Board's Report, and the Management's Discussion and Analysis Report:*

*(a) previous year figures have been re-grouped to conform to the current year presentation; and*

*(b) figures have been rounded off.*