

22nd

Annual Report
2005-2006



Hindustan Oil Exploration Company Limited

22nd Annual General Meeting

Date : September 28, 2006

Day : Thursday

Time : 10.30 A.M.

Place : 'Tropicana Hall', Taj Residency Vadodara, Akota Gardens, Akota, Vadodara-390 020

Contents

1	Highlights of 2005-06
2	Areas of Operations
4	Board of Directors
5	Directors' Report
9	Management Discussion and Analysis
13	Financial Review
19	Risk Management Report
23	Report on Corporate Governance
29	Corporate Governance Certificate
30	Accounts with Auditors' Report
54	Information pertaining to HOEC Bardahl India Limited (Subsidiary)
69	Consolidated Accounts with Auditors' Report
86	Glossary

Front Cover:

Aban VII Rig at Vinayaka-1 Location in
CY-OSN-97/1 Block

HIGHLIGHTS OF 2005-06

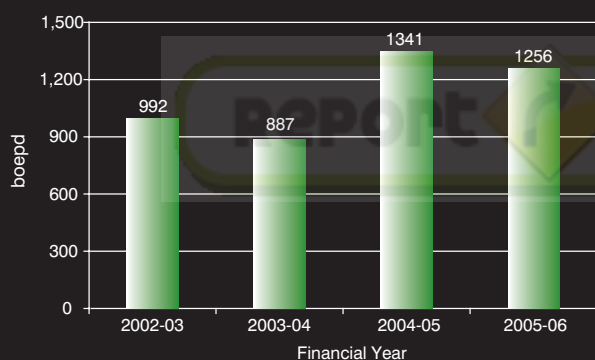
FINANCIAL HIGHLIGHTS

- **Total Income** of Rs 1,024 million (FY 2004-05: Rs 927 million), **up 10%**
- **Turnover** of Rs 970 million (FY 2004-05: Rs 858 million), **up 13%**
- **Profit before tax** of Rs 261 million (FY 2004-05: Rs 610 million), **down 57%**
- **Profit after tax** of Rs 175 million (FY 2004-05: Rs 385 million), **down 55%**
- **Operating Cash Flow**¹ of Rs 728 million (FY 2004-05: Rs 642 million), **up 13%**

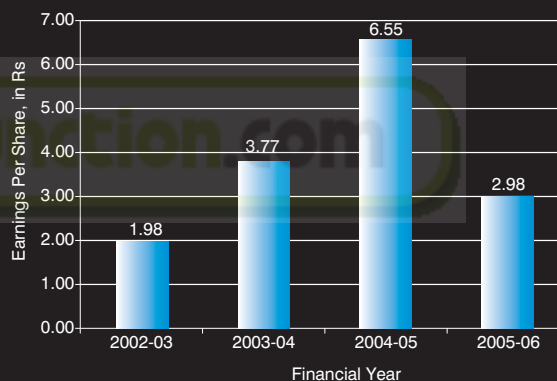
OPERATIONAL HIGHLIGHTS

- **Average production**² 1,256 boepd (FY 2004-05: 1,341 boepd), **down 6%**
- Production commenced from Pramoda oil field and North Balol gas field

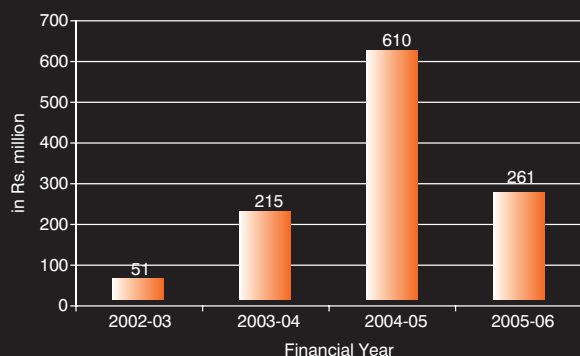
Production (Working Interest)



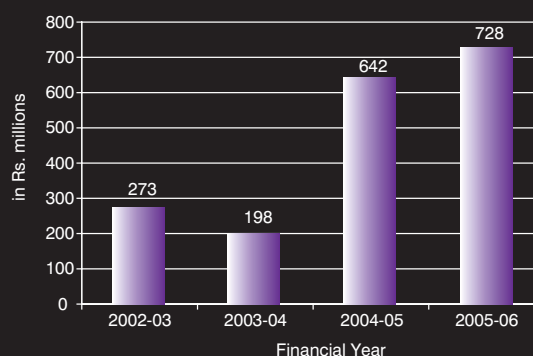
Earnings Per Share (EPS)



Profit Before Tax



Operating Cash Flow

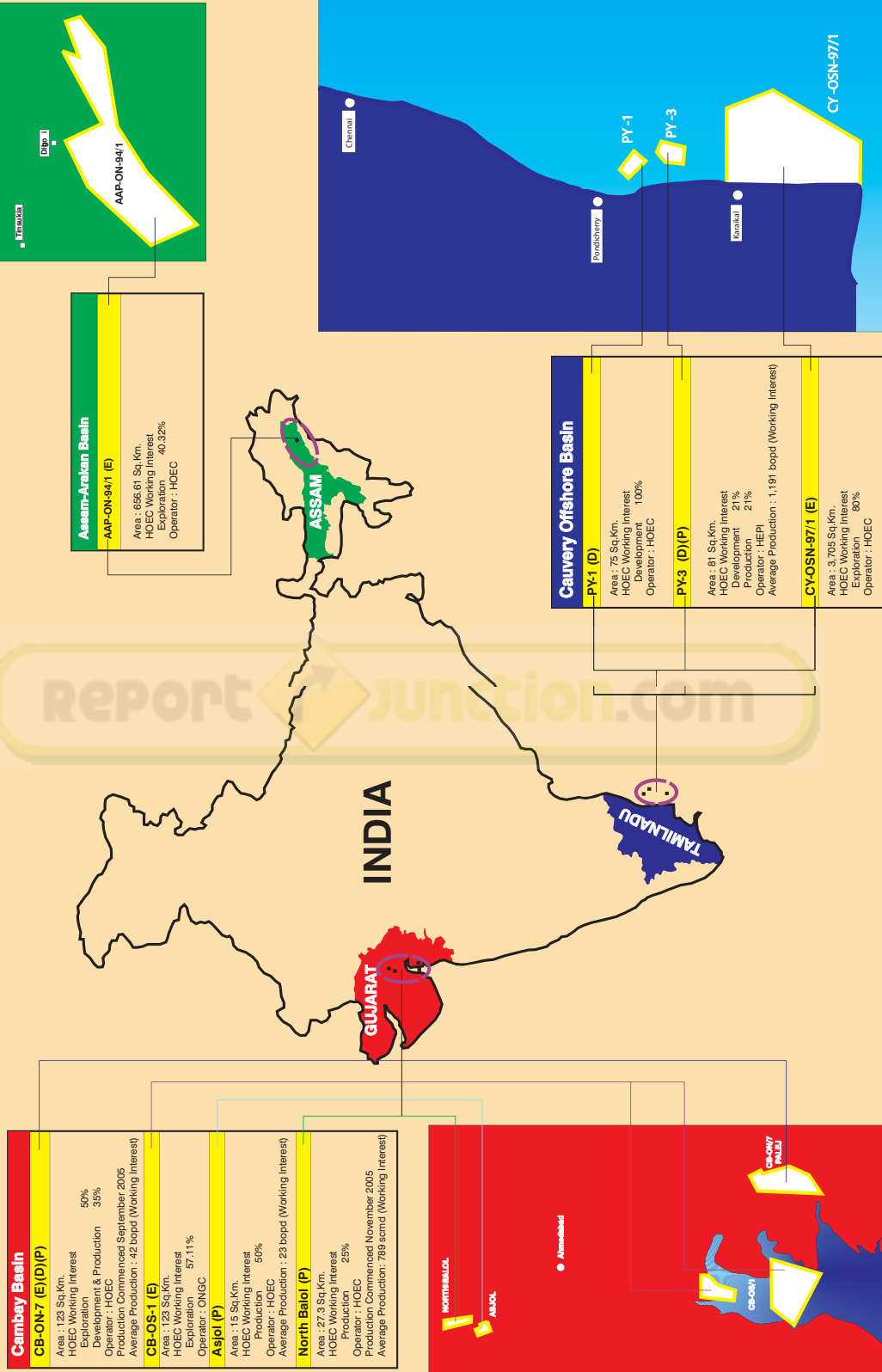


¹ Operating Cash Flow is before Working Capital Changes and Taxes

² Average production is on working interest basis

Areas of operation

HOEC's oil and gas assets consist of operated & non-operated acreages in Cauvery, Cambay and Assam-Arakan basins in India



Board of Directors



Mr. R. Vasudevan
Non-Executive Chairman

Mr. R. Vasudevan holds a B.A. (Hons) (Economics) degree from the University of Madras, an M.A. (Economic Statistics) degree from the University of Delhi and has also completed M.P.A. (Development Economics) from Harvard University, Boston, U.S.A. He has held various senior level positions in the ministries of the GoI including in the Prime Minister's Office, Ministry of Steel and Ministry of Petroleum and Natural Gas. He retired as Secretary to the GoI, Ministry of Power. He was also a founder director of Small Industries Development Bank of India.



Mr. Deepak S. Parekh
Non-Executive Director

Mr. Deepak S. Parekh is a Fellow of the Institute of Chartered Accountants (England and Wales). He has been a member of various committees set up by the Government of India, especially in the field of Finance and Capital Market. Mr. Parekh is the Executive Chairman of Housing Development Finance Corporation Ltd. and Non-executive Chairman of Infrastructure Development Finance Company Ltd., Siemens Ltd, & Glaxo Burroughs Wellcome (India) Ltd. He is recipient of Padma Bhushan award from the Government.



Mr. Finian O'Sullivan
Non-Executive Director

Mr. Finian O'Sullivan holds a degree in geology and geophysics from the University College Galway and pursued an international career spanning 17 years in geophysics and seismic acquisition with organizations such as Chevron, Geophysical Systems and Olympic Oil and Gas. He is currently the Chief Executive Officer of Burren Energy Plc. and is a director of Burren Energy India Ltd. and Burren Shakti Ltd.



Mr. Rahul Bhasin
Non-Executive Director

Mr. Rahul Bhasin holds a Post-Graduate Diploma in Management from the Indian Institute of Management, Ahmedabad. He is the Managing Partner of Baring Private Equity Partners (India) Private Ltd., a Senior Partner of Baring Private Equity Partners International and is also a member of the Investment Committee of the Baring Vostok Private Equity Fund. He is a member of the "CEO Forum" at the Economist Corporate Network.



Mr. Atul Gupta
Managing Director

Mr. Atul Gupta holds degrees in Chemical Engineering from Cambridge University and Petroleum Engineering from Heriot-Watt University. Besides Managing Director of Hindustan Oil Exploration Company Ltd., he is currently the Chief Operating Officer of Burren Energy Plc. and is a director of Burren Energy India Ltd. and Burren Shakti Ltd.



Mr. Manish Maheshwari
Joint Managing Director

Mr. Manish Maheshwari holds B.E. (Hons.) in Chemical Engineering, and Masters in Business Administration from SGBS, U.K. He has been with the Company for about three years. Prior to Hindustan Oil Exploration Company Ltd. he has worked with a Danish Development Financial Institution and Tata Group including upstream oil and gas venture.

DIRECTORS' REPORT

TO THE MEMBERS OF
HINDUSTAN OIL EXPLORATION COMPANY LIMITED

Your Directors have pleasure in placing before you the 22nd Annual Report and Audited Statement of Accounts for the year ended March 31, 2006.

FINANCIAL HIGHLIGHTS

	(Rs. in million)	
	2005-2006	2004-2005
Sales	969.53	858.23
Other Income	54.69	69.19
Gross Profit before Depreciation/ Depletion/Amortisation/Write Offs/ Taxation	757.26	682.26
Less: Depreciation/Depletion/ Amortisation	77.95	88.06
Less: Provisions & Write Offs	418.64	(15.91)
Profit Before Tax	260.67	610.11
Less: Provision for Current Tax	168.00	195.00
Less: Provision for Deferred Tax	(85.00)	30.20
Less: Provision for Wealth Tax	0.16	0.08
Less: Fringe Benefit Tax	2.60	0
Profit After Tax	174.91	384.83
Profit/(Loss) brought forward	710.50	392.65
Profit available for Appropriation	885.41	777.48
Less: Proposed Dividend on Equity Shares	58.74	58.74
Less: Dividend Tax	8.24	8.24
Balance carried to the Balance Sheet	818.43	710.50

Profit after tax is lower at Rs. 174.92 million as compared to Rs. 384.83 million for the previous year. After considering brought forward profit of Rs. 710.50 million, the profit available for appropriation is Rs. 885.42 million.

DIVIDEND

Considering the performance during the year under review, your Directors recommend dividend @ 10% (Rs. 1.00 per equity share of Rs. 10/- each) on the equity shares of the Company for the year ended March 31, 2006. The proposed dividend will amount to an aggregate of Rs. 66.98 million (including corporate dividend tax of Rs. 8.24 million).

OPERATIONAL HIGHLIGHTS

Operational Highlights are provided in Management Discussion and Analysis Report.

MANAGEMENT DISCUSSION AND ANALYSIS REPORT

In terms of Clause 49 of the Listing Agreement with the Stock Exchanges, Management Discussion and Analysis Report is appended to this Report.

CORPORATE GOVERNANCE

A separate report on Corporate Governance, along with a Certificate of Compliance from a Company Secretary in Practice, forms part of this report.

COST ACCOUNTING RECORDS

The Company has maintained cost records as required by Cost Accounting Records (Petroleum Industry) Rules, 2002 vide notification dated October 8, 2002.

LOAN AGAINST CHARGE ON PY-3 AND CB-ON-7 PARTICIPATING INTEREST AND RECEIVABLES

The Board of Directors have decided to refinance the loan of Rs. 350 million against PY-3 participating interest and receivables from ING Vysya Bank by substituting it with a loan of Rs. 1,700 million from UTI Bank and HDFC Bank by way of charge on participating interest and receivables of PY-3 and CB-ON-7. In this respect, the Company has repaid the entire loan amount to ING Vysya Bank in April 2006.

HOEC BARDAHL INDIA LIMITED [HBIL] (WHOLLY OWNED SUBSIDIARY OF HOEC)

Sales and Profit Before Tax of HBIL have registered a growth of 49% and 77% respectively to reach a level of Rs. 62.69 million and Rs. 19.14 million. This year growth has come as a result of concrete efforts in the automotive segment with the two wheelers giving a major thrust to the growth. HBIL has repaid the entire loan due to the Company.

The audited accounts of HBIL together with the report of the directors and auditors thereof, as required under Section 212 of the Companies Act, 1956 forms part of this Annual Report.

CONSOLIDATED FINANCIAL STATEMENTS

Pursuant to Accounting Standard AS-21 issued by the Institute of Chartered Accountants of India and the Listing agreement entered into with the Stock Exchanges, Consolidated Financial Statements are part of this annual report.

AUDITORS' REPORT

With reference to the observation made in Auditors' Report regarding unaudited joint ventures' accounts, we have to state that as per Production Sharing Contracts signed with the Government of India, the operators have been allowed time up to September 30 of the immediately succeeding year to submit audited accounts. Considering this, some of the operators have not submitted audited accounts till the Company's accounts are audited. In lieu of same, the statements of expenditure/unaudited accounts submitted by those operators have been incorporated.

Regarding non disclosure of outstanding payment to Small Scale Industries with respect to joint ventures, we have to state that the requirements of the said disclosure is not applicable to joint ventures and hence the required information has not been made available to the Company by the JV operator.

FIXED DEPOSITS

Your Company has not accepted any fixed deposits and, as such, no amount of principal or interest was outstanding as at the balance sheet date.

DIRECTORS

In accordance with the provisions of the Companies Act, 1956 and Articles of Association of the Company, Mr. Deepak S. Parekh will retire by rotation at the ensuing Annual General Meeting and he being eligible offers himself for re-appointment.

During the year under review Mr. Vimal Bhandari ceased to be Director. The Board places on record its sincere appreciation of the excellent and outstanding contributions made by him to the growth of the Company. The Board has appointed Mr. Rahul Bhasin as a Director in the casual vacancy caused by the resignation of Mr. Vimal Bhandari. Mr. Rahul Bhasin retires at the ensuing annual general meeting. The Company has received a proposal along with a deposit of Rs. 500/- from a member signifying the candidature of Mr. Rahul Bhasin for the office of the Director. The Board recommends his appointment.

MANAGING DIRECTOR

The term of the current Managing Director, Mr. Rakesh Jain expires on July 31, 2006. Mr. Rakesh Jain has conveyed his unwillingness to the Board that he is not seeking renewal of his term as Managing Director beyond July 31, 2006.

On behalf of the Board, Mr. R. Vasudevan, Chairman, expressed deep appreciation of services rendered by Mr. Rakesh Jain and in steering the Company with true professional grit, indefatigable energy and managerial skills. The Board wishes him well in all his future endeavors.

Mr. Atul Gupta, Director of the Company, has been appointed as the Managing Director of the Company subject to the necessary approvals.

The Board has also appointed Mr. Manish Maheshwari, the erstwhile Chief Financial Officer of the Company, as the Joint Managing Director w.e.f. August 1, 2006, subject to the shareholders approval. The Company has received a proposal along with a deposit of Rs. 500/- from a member signifying the candidature of Mr. Manish Maheshwari for the office of the Director.

The Board recommends their appointment.

COMPANY SECRETARY

The Company has appointed Mr. Vikash Jain, a member of the Institute of Company Secretaries of India, as the Company Secretary of the Company w.e.f. October 24, 2005.

PROMOTERS

During the year, Burren Shakti Limited (then Unocal Bharat Limited) have declared that they, along with Burren Energy (India) Limited have assumed the status of the promoters of the Company.

CONSERVATION OF ENERGY, TECHNOLOGY ABSORPTION AND FOREIGN EXCHANGE EARNINGS AND OUTGO.

A. Conservation of energy:

- (a) energy conservation measures taken : Nil
- (b) additional investments and proposals, if any, being implemented for reduction of consumption of energy : Nil
- (c) impact of the measures at (a) and (b) above for reduction of energy consumption and consequent impact on the cost of production of goods : Cost saving
- (d) total energy consumption and energy consumption per unit of production as per Form A of the annexure in respect of industries specified in the schedule thereto : Not applicable

B. Technology absorption:

- (a) efforts made in technology absorption as per Form B of the annexure :
Research and development (R & D)
 1. Specific areas in which R & D carried out by the company Nil
 2. Benefits derived as a result of the above R & D N.A.
 3. Future plan of action Nil
 4. Expenditure on R & D
 - i. Capital Nil
 - ii Recurring Nil
 - iii Total Nil
 - iv Total R & D expenditure as a percentage of total turn-over N.A.

Technology absorption, adaptation and innovation

1. Efforts, in brief, made towards technology absorption, adaptation and innovation: Nil
2. Benefits derived as a result of the above efforts, e.g., product improvement, cost reduction, product development, import substitution, etc. : Not Applicable

3. In case of imported technology (imported during the last 5 years reckoned from the beginning of the financial year), following information may be furnished

- Technology imported : Not Applicable
- Year of import : Not Applicable
- Has technology been fully absorbed : Not Applicable.
- If not fully absorbed, areas where this has not taken place, reasons therefore and future plans of action : Not Applicable

C. Foreign exchange earnings and outgo:

- activities relating to exports; initiatives taken to increase exports; development of new export markets for products and services; and export plans: Nil
- total foreign exchange used and earned

Particulars	Rs. Million
A. Foreign Exchange Earnings	Nil
B. Foreign Exchange Used	
➤ Cash Call Payment to Joint Ventures	149.80
➤ Expenditure in Foreign Currency	15.91
➤ Dividend	20.65
Total Foreign Exchange used	186.36

PARTICULARS OF EMPLOYEES

The particulars of employees required to be furnished pursuant to Section 217(2A) of the Companies Act, 1956 read with the Companies (Particulars of Employees) Rules, 1975 are attached hereto and form part of this Report.

RIGHTS ISSUE

The Company is in the process of coming out with a Rights Issue. The Draft Letter of Offer has been filed with SEBI and the Company has received in-principal approval for listing from the Stock Exchanges. The observation letter from SEBI is awaited.

AUDITORS

The Auditors, M/s. S. B. Billimoria & Co., Chartered Accountants, will retire at the forthcoming Annual General Meeting and they have not sought reappointment. As recommended by the Audit Committee, the Board at its meeting held on May 23, 2006 has recommended the appointment of M/s Deloitte Haskins & Sells as the auditors in place of retiring

statutory auditors M/s. S. B. Billimoria & Co., to hold office from the conclusion of the ensuing annual general meeting to the conclusion of the next annual general meeting. You are requested to consider their appointment.

DIRECTORS' RESPONSIBILITY STATEMENT

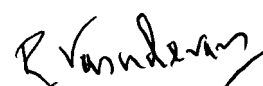
In accordance with the provisions of Section 217(2AA) of the Companies Act, 1956, with respect to Directors' Responsibility Statement, it is hereby confirmed:

- that in the preparation of the annual accounts for the financial year ended March 31, 2006, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- that the directors had selected such accounting policies and applied them consistently unless otherwise stated and made judgements and estimates that were reasonable and prudent so as to give a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit or loss of the Company for the year under review;
- that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Companies Act, 1956, for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities;
- that the directors had prepared the accounts for the financial year ended March 31, 2006 on a 'going concern' basis.

CONCLUSION AND ACKNOWLEDGEMENT

Your Directors place on record their gratitude for the support and co-operation received from Government of India's agencies namely, Ministry of Petroleum & Natural Gas, Directorate General of Hydrocarbons, Government of Gujarat, Government of Tamil Nadu, Tamil Nadu Electricity Board, Consortium Partners and Bankers. We express our sincere appreciation to our dedicated and committed team of employees who have contributed to the growth of the organization.

For and on behalf of the Board



Place : New Delhi
Date : July 29, 2006

R. Vasudevan
Chairman

ANNEXURE TO THE DIRECTORS' REPORT

Statement of particulars of employees pursuant to the provisions of Section 217(2A) of the Companies Act, 1956 read with the Companies (Particulars of Employees) Rules, 1975 and forming part of the Directors' Report for the year ended March 31, 2006.

Name	Designation	Remuneration received	Nature of employment	Nature of duties of the employee	Qualifications of the employee	Experience of the employee (in years)	Date of commencement of employment	Age	The last employment such as employee before joining the Company	The number of equity shares held by the employee	The percentage of equity shares held by the employee	Period of Employment during the Financial Year
												From To
Mr. Rakesh Jain	Managing Director	7,624,943	Contractual	Overall management of the Company	B.Tech (Mechanical Engineering): PGDM from IIM, Calcutta	23	16-Jun-03	47	Principal Consultant, Tata Consultancy Services	1,000	Negligible	1-Apr-05 31-Mar-06
Mr. Manish Maheshwari	Chief Financial Officer	2,498,364	Permanent	Head of Finance, Accounts, Commercial & Legal	BE (Hons.), MBA (Strathclyde University U.K.) Danida Fellowship	16	1-Oct-03	39	Danish International Investment Fund	—	—	1-Apr-05 31-Mar-06
Dr. Udayan Dasgupta	Chief - Exploration Ventures	2,569,966	Permanent	Head of Exploration & Subsurface activities	Phd - Geology (University of Toronto)	32	10-Jan-94	58	Oil India Limited	—	—	1-Apr-05 31-Mar-06
Mr. J. Muthukumar	Chief - Well Construction Services	4,099,644	Permanent	Head of Drilling	B.E. (Chemical), M.Tech (Petroleum Engg.)	20	19-Oct-04	44	Cairn Energy India (Pty.) Limited	—	—	1-Apr-05 31-Jan-06

Notes:

- Gross remuneration as above includes salary, taxable allowances, Company's Contribution to Provident Fund and Superannuation Fund, Gratuity paid (but excludes Company's contribution to Gratuity Fund), reimbursement of medical expenses, personal accident & mediclaim insurance premium, leave travel assistance and monetary value of perquisites calculated in accordance with the provisions of the Income Tax Act, 1961 and the Rules thereunder.
- All the above named persons are eligible for all employee benefits eligible to the same class of employee.
- The term of the current Managing Director, Mr. Rakesh Jain, expires on July 31, 2006. Mr. Rakesh Jain has informed the Board that he is not seeking renewal of his term as Managing Director beyond July 31, 2006.
- Mr. J. Muthukumar was employed only for a part of the year.
- Mr. Manish Maheshwari has been appointed as an Additional Director & Joint Managing Director w.e.f. August 1, 2006. Before this appointment he held the position of the Chief Financial Officer of the Company.
- None of the above named person is a relative of any Director of the Company.

MANAGEMENT DISCUSSION AND ANALYSIS

OPERATIONAL REVIEW

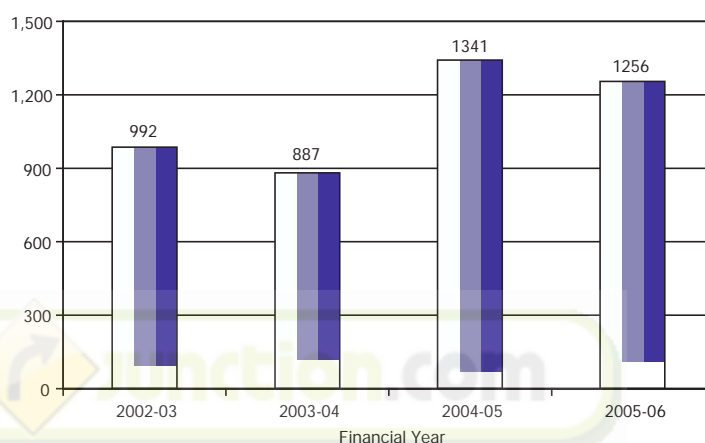
Reserves and Production

As of March 31, 2006, internal estimate of Company's Proved and Probable (2P) reserves on working interest basis is 39.59 mmboe.

Production during FY 2005-06 is 458,583 bbls of Crude Oil and 0.3 Mmscm of Gas respectively. The Company has inventory of prospects in its license areas namely CY-OSN-97/1, AAP-ON-94/1, CB-OS-1 and CB-ON-7.

Production (Working Interest Basis) (BOEPD)

The average production (working interest) during the FY 2005-06 is 1256 BOEPD lower than last fiscal on account of natural decline in production in PY-3.



Cauvery Basin

Block CY-OS-90/1 (PY-3 Field)

Operations during the year

During 2005-06, the PY-3 Consortium acquired new 3D Seismic data and interpretation of the same is underway.

PY-3 field average gross total production decreased to 5,671 bopd in 2005-06 from 6,269 bopd in the previous year, on account of natural decline in the production. Production on net entitlement basis to HOEC averaged 977 bopd in FY 2005-06 compared to 1,202 bopd in 2004-05. The decrease in the entitlement is due to increase in the profit oil sharing with the Government of India from 10% to 25% as per the provisions of the Production Sharing Contract.

Due to decline in production, the average operating expenditure was \$ 8.4/bbl vis-à-vis \$ 7.6/bbl in the previous year.

Future Plans

Based on interpretation of new 3D data and revised Geological and Reservoir Modeling, the JV Consortium shall consider drilling additional wells to enhance production.

