

Management's discussion & analysis

(Forming part of the Directors' Report for the year ended 31st March 2010)

INDUSTRY STRUCTURE & DEVELOPMENTS

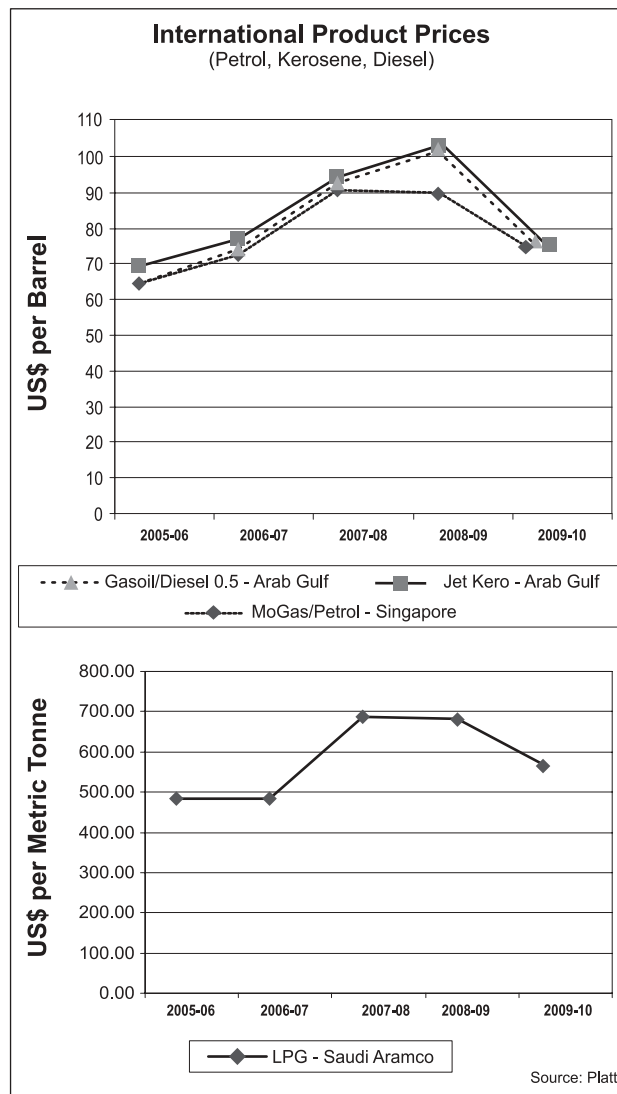
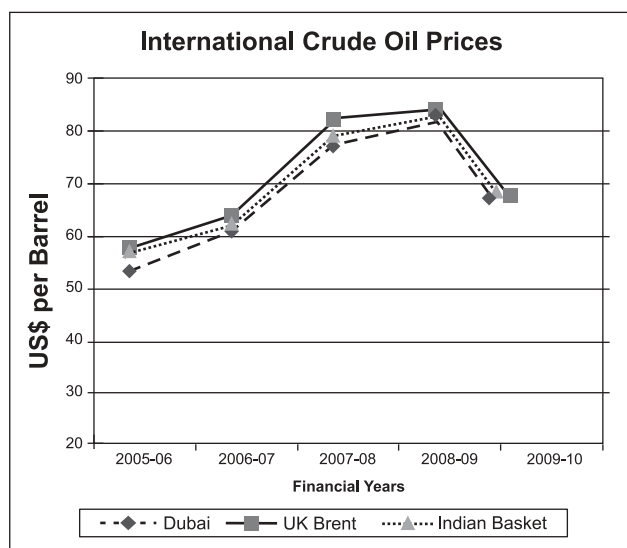
World Economy

During the course of the year, international economic conditions exhibited a marked improvement with the global economy getting into an early recovery mode. The vital statistics of the engine of the world economy entered the positive territory. After June 2009, world trade flows entered into an expansionary mode after declining for several months and GDP growth turned positive. A corrective policy action on both fiscal & monetary fronts has been at the very core of the recovery witnessed. However, the recovery process has not been uniform and has varied in speed & strength across countries and regions, with emerging economies leading the way.

While the recovery has been early, it is still nascent and fragile and the key risks and destabilising factors continue to exist. This calls for further reforms in the financial markets and controlling fiscal deficits in the light of rising commodity prices & high unemployment rates. The recent debt crisis in Greece has only highlighted the fragility of the recovery process and raised questions on the credibility of the economic recovery and the stability of financial markets.

Indian Economy

Indian economy has been amongst the first economies to emerge out of the grips of recessionary forces in a incredible recovery led by the industrial and services sectors. The acceleration in the growth of the manufacturing sector from 3.2% recorded in 2008-09 to 10.8% during 2009-10 has been particularly remarkable, especially in the automobiles, plastics & chemicals



sub-sectors. Besides, the turnaround witnessed in the infrastructure sectors such as electricity, telecom, coal, roads etc. has also been particularly encouraging.

Trade flows, which had been one of the foremost channels of transmission of global recession to India, returned to a more progressive mode in the latter part of the year, after a prolonged period of contraction. Along with this, the resurgence of portfolio capital flows since the first quarter of

2009-10 with a net FII inflow of Rs. 110.8 thousand crores after a stark reversal witnessed in 2008-09, when there was a net outflow of Rs. 48.3 thousand crore, set the capital account back to normal. This was further bolstered by buoyant FDI inflows.

However, poor agriculture performance; surging food inflation (which is feared to lead to a generalized increase in inflation), fiscal imbalances and innate infrastructural weaknesses of the Indian economy are seen by experts as the key risks to the robust growth and stability of the Indian economy.

OUTLOOK

Global Oil & Gas

The slump in the global economy hit the oil sector with world oil consumption and supply falling consecutively in 2008 & 2009. However, as the world economy is now on the recovery path both supply & consumption are expected to grow. After exhibiting the highest intra-year volatility in 2008-09, and touching a rock bottom of US\$ 40/bbl in 2008, international crude oil prices gradually firmed up since March 2009 and had risen by 69% on year-on-year basis in March 2010.

Owing to the low oil prices in the beginning of the year and slump & uncertainty in demand during the year, many international oil & gas companies cut back their capital expenditure. This trend is expected to reverse now with the demand set to normalise and rising crude oil prices. The recent major success achieved by the North America companies in shale gas development, led by technological breakthroughs which have made it easier & cheaper to extract gas from shale, is likely to change the demand-supply dynamics in US & affect the LNG industry globally.

India Oil & Gas

The Indian oil & gas sector received a major impetus with domestic oil & gas supplies scaling up significantly (after years of stagnation) with the start of supplies from Rajasthan & KG basin. During 2009-10, crude oil production increased by 3.5% & natural gas production by 69.4%. Given India's high dependence on imported hydrocarbons, this success story needs to recur for which policy, investments and R&D efforts for enhancing domestic supplies need to gear up.

During the year, the VIII round of NELP & the IV round of Coal Bed Methane (CBM) were held with the participation of 62 companies, including 10 foreign companies. For NELP VIII, 76 bids for 36 blocks out of the 70 blocks offered were received and for CBM IV, 26 bids for 8 blocks out of the 10 blocks offered were received.

Indian refineries have been performing well on the operational front with a capacity utilization of 107.4% in 2009-10. On the financial front, Gross Refinery Margins have been weak due to middle distillate (accounting for a bulk of Indian refinery output) cracks being under pressure and the consequent diminutive gap between these & crude. During the year, with the improvement in economic conditions, domestic consumption of POL products grew by 3.4% and exports also rose by 38% in terms of volume.

Unlike other parts of the world, investments and capital expenditure in the oil & gas sector in India was not stalled in the wake of the global economic crisis. The three upcoming public sector refineries would further augment the domestic refining capacity. Surplus refining capacity coupled with

the relatively low capital & operating costs in India will help position the country as a refinery hub in Asia especially catering to the export demand of high growth centres in South East Asia.

Under the pricing & subsidisation policy, domestic consumers were being protected from rising crude oil prices with an incomplete pass through. However, an expert committee under the Chairmanship of Dr. Kirit Parikh recommended the complete decontrol of MS & HSD prices and replacement of oil bonds by cash subsidy for under recoveries on LPG & SKO. The Government of India decided, on 25th June 2010, that the pricing of MS & HSD both at the refinery gate and the retail level will be market determined. While MS has been fully decontrolled, the price of HSD is expected to be fully decontrolled in due course. This is a significant policy move, which is expected to create a more efficient petroleum sector in the country.

Issues such as CSR, sustainable development and R&D are increasingly getting the attention of policy makers. Consequently, the central PSU oil companies are required to give a weightage of 5% to each of these in their MoU with the Ministry from the year 2010-11.

The PSU oil marketing companies will be partnering the government to increase availability of LPG in rural areas through the Rajiv Gandhi Grameen LPG Vitarak Yojana which was launched in October, 2009. In addition, the provision of community LPG kitchens through Corporate Social Responsibility funds will also make a significant difference. The implementation of a smart card system, after the establishment of a nationwide Unique Identification system, is now being increasingly looked at as a solution to the inefficient system of price subsidies on SKO & LPG.

A policy & regulatory framework has been evolving in the recent years to facilitate the development of gas pipeline infrastructure, especially in the context of increase in domestic gas production. During the year, the grant



Launch of Rajiv Gandhi Grameen LPG Vitarak Yojana

of infrastructure status to City Gas Distribution pipelines has been a positive development that is likely to spur further growth of this sector.

The Ethanol-Blended Petrol Programme has not yet stabilised as ethanol supplies have not been adequate enough to meet the target for a 5% blending. Further, Oil Marketing Companies have been facing certain constraints with respect to free inter-state movement of ethanol and the levy of duties on it by the state governments.



IndianOil

Another major policy development in the sector was the finalization of the oil sector Vision - 2015 for 'Consumer Satisfaction and Beyond' by the Ministry of Petroleum & Natural Gas. The vision with regard to the customers would cover four broad areas i.e. LPG, Kerosene, Auto Fuels and CNG/PNG.

A series of fuel quality improvement projects have been under implementation in the sector to meet the various fuel emission norms. During the year, preparations were on for supplying BS-IV fuels in 13 Indian cities. The successful implementation of the same from 1st April 2010 with raised retail prices has been an encouraging development.

OPPORTUNITIES AND CHALLENGES

As a leading energy corporate in a rapidly growing emerging economy, challenges & opportunities are plentiful for the Corporation.

The core business of the corporation, i.e. refining and marketing presents sizeable opportunities with domestic demand projected to grow at a 3.9% annually over the long term (2007-2030) vis-à-vis the world average growth rate of 0.9%. Moreover, benefiting from India's geographical advantage, the Corporation aims at seizing export opportunities in the overseas markets of South East Asian countries. Commencement of work for the Corporation's 15 MMTPA Paradip Refinery Project on the east coast is also a significant development.

In recent years, the rapid growth in the Indian economy has increased its appetite for petrochemicals, but per capita consumption still continues to be way below the world average. Global petrochemicals demand, which was hit by the global economic crisis, is expected to recover with Asia registering a sharper rebound. The Corporation's investments are in line to garner growth opportunities in this space and move up the petrochemicals value chain. With its LAB & PTA markets having grown over the years, and new projects such as the Naphtha cracker and Styrene Butadiene Rubber plant at Panipat further expanding its offerings, IndianOil is poised to move up the value chain.

Exploration & Production (E&P) business is an important area and a major breakthrough is awaited to reap returns from the Corporation's E&P investments made over the years. Not only has our portfolio of E&P assets, (both in India and abroad) increased, capabilities have been enhanced after we have taken on the role of an operator in newly-acquired E&P blocks.



Exploring the high seas

During the year, the Corporation's overseas presence has expanded further with the takeover of a stake in a block in Venezuela.

The Corporation perceives an increase in opportunity for sourcing LNG to India from the global market due to a reduction in demand in USA caused by an increase in production of Shale Gas in that country. However, sourcing LNG would depend upon various other factors such as price, location of the liquefaction plant etc.

There is a growing realisation across the world of the importance of sustainable development and its role in the way corporates conduct business. The Corporation is focused on the need to integrate sustainability in our core business function. While many initiatives are already underway, the Corporation intends to undertake a companywide environmental mapping exercise.

Across the world, the oil & gas sector is under regulatory and moral pressure to reduce both direct & indirect CO₂ emissions. In the coming years, we too will be increasingly expected to provide solutions and make investments in this area. The Corporation understands its responsibility in this regard and energy efficiency has generally been a focus area for us for many years now. The Corporation is also diversifying into renewable energy and this includes forays into wind & solar power businesses. These are increasingly policy driven, especially with the launch of the National Action Plan on Climate Change and its eight missions. Bio-fuels have been an area of focus for the Corporation and we have made significant investments and tie-up partnerships and alliances. During the year, the Corporation decided to establish a new department exclusively to work in the renewable energy business.

The Corporation has viewed the rural sector as an area of immense opportunities, and has had a reputation of providing innovative energy services solutions to the rural population through its Kisan Seva Kendra. Recently, our forays into the sales of solar lanterns in the rural areas have been richly rewarded. Looking forward, the Corporation aims to transform the energy challenge deficit in the rural areas into a business opportunity.

The ongoing nuclear renaissance in the world and India is seen by the Corporation as an important opportunity in meeting the energy challenge of the future as well as addressing climate change concerns. During the year, the Corporation entered into a MoU with the Nuclear Power Corporation of India for working out strategies for investments in nuclear energy.

With a view to further boost the scope and scale of operations of Navratna CPSEs, the Government has granted the 'Maharatna' status to IndianOil alongwith three other CPSEs, with a higher delegation of financial powers to their respective boards. However, the power under the Maharatna Scheme can be invoked only after the requisite numbers of Independent Directors are inducted on the Board of the Corporation as per the SEBI guidelines.

The Corporation is facing challenges in getting skilled manpower for some of its new verticals such as E&P & petrochemicals, which require manpower with specialised skill sets which are different from those of our downstream petroleum business.

The existing pricing & subsidy policies of the Government have created conditions that are a continuing challenge for the operation of the Corporation. Financial losses and under-recoveries seriously limit the liquidity availability and increase the debt burden on the Corporation.

RISKS AND CONCERNS

With crude oil prices rising and under-recoveries piling up, delays in receipt of compensation from Government, there is an increased pressure on the Corporation to raise debt which may affect its capital expenditure plans. In addition, large scale foreign currency transactions with wide fluctuations in foreign exchange always pose a risk.

Given the nature of the crude oil market, supply disruptions emanating from geo-political tensions pose a risk to the smooth operations of the Corporation. As a cushioning strategy against possible supply disruptions, the Corporation has been widening its crude basket to make it more geographically diverse.

The unfortunate fire incident at the Corporation's Jaipur Terminal, has highlighted the fact that safety concerns need greater attention. In this regard, the Corporation has taken strong action to strengthen its safety systems so as to minimise the risk of such incidents. As a result of extensive deliberations and studies of the incident, a Board level committee has been now constituted to review safety measures at all levels.

The Corporation's Refineries, Marketing & Pipelines infrastructure is spread across the length & breadth of the country. With a rise in security threats, both internal and external, the Corporation is on a constant vigil and upgrading its security systems. With significant investments in E&P assets, the risk of policy instability, especially with regard to production sharing agreements and price fixation, is an area of concern.

FINANCIAL REVIEW

Turnover

The turnover of the Corporation (inclusive of excise duty) for the year ended March 31, 2010 was Rs. 2,71,074 crore as compared to Rs.2,85,398 crore in the previous year. The total sales of products (including gas and petrochemicals) for 2009-10 was 69.92 MMT as against 66.76 MMT during 2008-09.

Profit Before Tax

The Corporation has earned a Profit Before Tax of Rs 14,106 crore in 2009-10 as compared to Rs.4,329 crore in 2008-09.

Provision for Taxation

An amount of Rs. 3,885 crore has been provided towards income tax for 2009-10 considering the applicable income tax rates as against Rs.1,379 crore provided during 2008-09.

Profit After Tax

The Corporation has earned a Profit After Tax of Rs.10,221 crore during the current financial year as compared to Rs.2,950 crore in 2008-09.

Depreciation & Amortisation

Depreciation for the year 2009-10 was Rs.3,240 crore as against Rs.3,038 crore for the year 2008-09.



Recognition beyond boundaries - Financial Management.

Interest (net)

Net Interest Income of the Corporation for the current year was Rs.446 crore as against net interest expenditure of Rs. 2,560 crore during 2008-09.

Borrowings

The borrowings of the Corporation were Rs. 44,566 crore as on March 31, 2010 as compared to Rs. 44,972 crore as on March 31, 2009. The Total Debt to Equity ratio as on 31st March, 2010 works out to 0.88:1 as against 1.02:1 as on 31st March, 2009 and the Long Term Debt to Equity ratio stands at 0.36:1 as on 31st March, 2010 as against 0.36:1 as on 31st March, 2009.

Capital Assets

Gross Fixed Assets (including Capital Works in Progress) increased from Rs.80,485 crore as on 31.03.2009 to Rs.93,358 crore as on 31.03.2010.

Investments

Investments as on 31st March, 2010 were Rs.22,370 crore as compared to Rs.32,232 crore as on 31st March, 2009. The decrease in investments during the year is mainly due to sale of Government of India Special Oil Bonds. The aggregate market value of quoted investments as on 31st March, 2010, i.e., investments made in ONGC Ltd., GAIL (India) Ltd., Oil India Ltd., Chennai Petroleum Corporation Ltd., Petronet LNG Ltd. and Lanka IOC Plc., is Rs. 23,844 crore (as against the acquisition price of Rs.3,828 crore).

Net Current Assets

Net Current Assets stood at Rs. 14,637 crore as on March 31, 2010 as against Rs. 9,260 crore as on March 31, 2009.

Earnings Per Share

Earnings Per Share works out to Rs.42.10 for the current year as compared to Rs.12.15 in the previous year.

Earnings in Foreign Currency

During the year, the Corporation earned Rs.13,743 crore in foreign currency as against Rs.14,963 crore in 2008-09, which is mainly on account of export of petroleum products.

SEGMENTWISE PERFORMANCE

(Rs. in crore)

	Sale of Petroleum Products	Other Businesses	Eliminations	Total
External Revenue	241,996	27,140	-	269,136
Inter Segment Revenue	1,378	359	-	1,737
Total Revenue	243,374	27,499	-	270,873
Operating Profit	13,976	332	-	14,308

Notes:

- Segment Revenue comprises of Turnover (Net of Excise Duties), Subsidy & Grants received from Government of India and Other Operating Income.
- Other Business segment comprises; Sale of Imported Crude Oil, Sale of Gas, Petrochemicals, Oil & Gas Exploration Activities, Explosives & Cryogenic Business and Wind Mill Power Generation.

INTERNAL CONTROL SYSTEMS

The Corporation has adequate internal control systems commensurate with the size and nature of its business. In addition, there are detailed manuals on various aspects of the business activities, accounting policies and guidelines. The Board of Directors regularly monitors the performance of your Corporation.

Further, the Corporation has a full-fledged independent Internal Audit Department headed by an Executive Director (below Board level), who reports to the Chairman. The Internal Audit carries out extensive audits round the year covering each and every aspect of business activity so as

to ensure accuracy, reliability and consistency of records, systems and procedures. An Audit Committee comprising of independent Directors and constituted by the Board of Directors reviews the recommendations and observations of the Internal Audit Department regularly.

HUMAN RESOURCES / INDUSTRIAL RELATIONS

The industrial relations climate in the Corporation remained harmonious, peaceful and cordial during the year. Under the employees participation schemes, shop floor councils and plant level councils are functioning in the units. Mentoring, as an HR initiative, has been institutionalised and all new recruits have been allotted Mentors for smooth induction into the Corporation. The pay revision for officers effective 01.01.2007 have been implemented during the year. The employee strength of IndianOil as on 31st March, 2010 was 34,363 including 14,210 officers.

Information regarding Corporate Social Responsibility, Environmental Protection & Conservation, Technological Conservation, Renewable Energy Developments, Foreign Exchange Conservation has been included in the Director's Report and Annexure thereto.

CAUTIONARY STATEMENT

Statements in the Management's Discussion & Analysis describing the Company's focal objectives, expectations or anticipations may be forward looking within the meaning of applicable securities, laws and regulations. Actual results may differ materially from the expectations. Important factors that could influence the Company's operations include global and domestic demand and supply conditions affecting selling prices of products, input availability and prices, changes in Government regulations/tax laws, economic developments within the country and factors such as litigation and industrial relations.

H-CNG

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H-CNG
Cleaner Fuel for
Greener Tomorrow

INDIAN OIL





New generation fuels