**July 24, 2024**

# Essar Oil and Gas Exploration and Production Limited: [ICRA]A- (Stable) assigned for BLR & [ICRA]A2+ assigned for CP; rating reaffirmed for Issuer Rating

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Issuer rating** | - | - | [ICRA]A- (Stable), reaffirmed |
| **LT Fund-Based-Term Loan** | 0.00 | 1222.00 | [ICRA]A- (Stable); assigned |
| **ST-Commercial Paper** | 0.00 | 50.00 | [ICRA]A2+; assigned |
| **Total** | **-** | **1272.00** | |

**Instrument details are provided in Annexure-I*

## Rationale

The ratings assigned to Essar Oil & Gas Exploration and Production Limited (EOGEPL/the company) factors in the presence of the company's long-term gas sale and purchase agreement (GSPA) with GAIL India Ltd [rated [ICRA]AAA(Stable)/[ICRA]A1+] at a competitive pricing for a period of 15 years (starting FY2018) till August 2033 along with the pipeline connectivity with the national grid through the Urja Ganga pipeline which mitigates the evacuation risks. After the connectivity with the Urja Ganga pipeline, the company's gas production rose to 0.86 mmscmd in FY2024 from 0.54 mmscmd in FY2021 and is expected to rise further with the addition of new wells.

The outlook for gas consumption in India remains positive with rising demand from sectors like city gas distribution, fertiliser power, refining etc. and the high import dependence, which mitigates the demand risk for the gas produced by EOGEPL. At present, EOGEPL's gas remains competitively priced vis-à-vis imported regasified liquified natural gas (R-LNG), thus easing the offtake risk.

The overall coverage and capitalisation metrics have improved materially over the course of FY2023 and FY2024 because of increased production and healthy realisations. The coverage and capitalisation indicators are expected to improve with rising production and repayment of debt obligations. The rating is further supported by the successful implementation of the resolution plan by the lenders of EOGEPL along with the creation of a debt service reserve account (DSRA) for one quarter's repayment obligations. The rating also takes comfort from the presence of a trust and retention account (TRA) mechanism, wherein debt servicing gets priority over capital expenditure.

The rating is constrained by the exposure of the cash flow to the volatility in crude oil prices, which drive the realisations for the gas sold by the company. The company is exposed to geological, technological and execution risks inherent in exploration and production (E&P) activities. The cash flow will also remain susceptible to the gas production volumes which can be uncertain for E&P blocks. The company has large capex plans (of ~Rs. 700 crore over the course of FY2025 to FY2027) to drill new wells and increase production from the existing wells. Accordingly, the ability to ramp up production as planned will remain a key monitorable. Besides, the company derives almost all its cash flow from a single field which exposes it to asset concentration risks.

The Stable outlook on the rating of EOGEPL reflects expectations of a healthy ramp-up in gas production, supported by a favourable gas demand and pricing scenario, leading to an improvement in its cash accruals in the near to medium term.

## Key rating drivers and their description

### Credit strengths

**Long-term gas supply agreement with GAIL; pipeline connectivity in place –** EOGEPL has a long-term GSPA with GAIL for 15 years, starting August 2018, with take-or-pay clause for the entire offtake which, however, would be triggered once the gas sale of 1.2 MMSCMD is achieved. However, at present, the production level is at 0.92 mmscmd and thus the take-or-pay clause is yet to kick in. Further, the pricing based on the GSPA contract remains competitive for GAIL vis-a-vis the imported long term or spot LNG, thereby reducing the offtake risk. Under the GSPA, the gas price has a floor of $5.215/MMBtu and a cap of $13.45/MMBtu, based on a formula linked to the average Brent crude price of last three months. These prices are applicable for the first 10 years of the contract and is subject to renegotiation at the end of the 10th year i.e. in FY2028. Additionally, due to the efficient payment mechanism built within the GSPA, EOGEPL receives payments on a fortnightly basis.

Apart from the long-term contract with GAIL, the company has entered into various short-term contracts with several customers for the sale of coal bed methane (non-GAIL CBM sales) and compressed natural gas (CNG). For these contracts, the company is able to charge an average $3-4/mmbtu premium over GAIL prices. Non-GAIL CBM is sold mostly to industrial customers connected through a dedicated pipeline from EOGEPL's supply facility, while the CNG sales are through cascades. Connectivity with the Urja Ganga pipeline (setup by GAIL) was achieved in May 2021, which enabled the company's gas field to get connected to the national gas grid and as a result the company has been able to ramp up its production. The connectivity to the GAIL pipeline has eliminated the evacuation risk for the field as it remains attractively priced and the dependence of India on imported LNG remains high.

**Expected improvement in gas production to boost cash generation –** The commissioning of the GAIL pipeline in FY2022 helped EOGEPL ramp up its production to 0.86 mmscmd in FY2024 from 0.54 mmscmd in FY2021. Further, the company has large capex plans to ramp up production from the existing and new wells. The company had commissioned 348 wells (under phase-I) till FY2018. An additional 89 wells have been commissioned as on date as part of its ongoing plan to drill 200 wells. Going forward, the gas production and sales from the fields is expected to witness healthy growth with the incremental wells being commissioned. Additionally, the company plans to undertake enhancement activities to improve production from the phase-I wells. The ability of the company to meet the envisaged volumes will remain a key monitorable as the E&P activities remain vulnerable to geological, technological and execution risks.

**Trust & retention account mechanism in place to monitor cash flow to provide first preference to debt servicing -** The presence of a trust and retention account (TRA) mechanism, after the debt restructuring in 2022 by the existing lenders, ensures the accruals are available to meet the debt obligations and capex on time. The successful operations of the TRA without any cash upstreaming to group companies would remain a key monitorable. Further, the allowance of capex for both maintenance and growth would be based on the lenders' approval only.

**Favourable outlook for natural gas consumption in India-** The demand for natural gas is expected to increase significantly in the coming years due to increasing urbanisation, growing energy requirement and the need for more environment-friendly energy sources. The use of natural gas in the refinery, petrochemical, power, city gas distribution and fertiliser sectors would drive the growth in natural gas demand. As India remains dependent on the more expensive imported LNG, the offtake risk for the gas produced by EOGEPL is mitigated to a large extent.

### Credit challenges

**Cash flow exposed to volatility in production level and gas pricing along with dependence on a single field** - Gas prices have witnessed significant volatility in the past. Further, the company has GSPA with GAIL and the prices in the agreement are linked to Brent crude oil prices. However, the presence of a floor for gas pricing in the GSPA with GAIL and the ability of the company to sell natural gas to non-GAIL users at a premium provide comfort to some extent. Further, the company has plans to undertake capex to improve the output from its existing wells and drill new ones to ramp up production. However, the fields are exposed to the inherent risks of exploration and production activities wherein the final production level can be lower than the envisaged output. Besides, the company derives almost all its cash flow from a single field which exposes it to asset concentration risks.

**Significant capex plans -** EOGEPL plans to drill additional 200 wells (200 vertical/directional wells) as part of the new well drilling programme to increase the production level to ~2.01 mmscmd (348 existing + 200 new wells). The new drilling campaign started from July 2022 and 89 new wells have been drilled as on date, of which 76 have been put on production. The capex for developing 200 wells is estimated at ~ Rs. 1,100 crore, of which ~Rs. 411 crore has been incurred till the end of FY2024 through internal accruals and ~Rs. 340 crore will be incurred in FY2025 through internal accruals. The company will remain exposed to the risks associated with uncertainty related to the production level, as is the case with E&P activities. The uptick in the volumes and the associated cash flow will remain a key monitorable, going forward.

## Liquidity position: Adequate

EOGEPL's liquidity is expected to remain adequate, supported by expected annual net accruals of ~Rs. 600-750 crore per annum over the next two years i.e. FY2025 and FY2026. The company's cash and cash equivalents stood at Rs. 105 crore, including DSRA of ~Rs. 80 crore, as on March 31, 2024. EOGEPL's net working capital requirements remained low owing to the timely receivables from strong counterparties. The net cash accruals are adequate to meet its repayment obligation of ~Rs. 229 crore in FY2025 and ~Rs. 262 crore in FY2026. The company has planned a capex of ~Rs. 340 crore per annum in FY2025 and FY2026, which will be funded entirely through internal accruals.

## Rating sensitivities

**Positive factors –** Timely execution of the ongoing capex within the envisaged capital outlay and timelines and the subsequent ramp-up of the gas volumes sales, resulting in a significant improvement in the company's liquidity and debt coverage metrics may lead to an upgrade.

**Negative factors –** A lower-than-expected growth in gas production, weakening the company's debt servicing capabilities, and/or higher-than-expected debt-funded capex moderating the leverage and coverage metrics may warrant a downgrade. Further, any non-compliance with the TRA mechanism could be a negative for the rating.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Oil Exploration & Production |
| **Parent/Group support** | Not applicable |
| **Consolidation/Standalone** | Standalone |

## About the company

Essar Oil and Gas Exploration and Production Limited (EOGEPL) was incorporated on May 10, 2016, and is a wholly-owned subsidiary of Essar Exploration & Production Limited, Mauritius (EEPL), which is a holding company of the exploration & production (E&P) assets owned by Essar Global Fund Limited, a global fund with ~$8-billion assets under management. EEPL holds both conventional (crude oil) E&P assets with a resource base of 3.4 billion barrels of oil equivalent (BBOE) as well as unconventional (CBM and shale) E&P assets with a resource base of 14 trillion cubic feet (TCF) in India and overseas.

The Indian E&P assets are held through EOGEPL. It holds two E&P blocks in India at Raniganj and Mehsana. The company is a leading player in the production of CBM with 99% of its revenue being generated by the Raniganj block in West Bengal.

### Key financial indicators (audited)

| | FY2022 | FY2023 | FY2024* |
|---|---|---|---|
| **Operating income** | 493.6 | 891.6 | 838.9 |
| **PAT** | 212.1 | 335.2 | 359.4 |
| **OPBDIT/OI** | 46.0% | 71.4% | 72.6% |
| **PAT/OI** | 43.0% | 37.6% | 42.8% |
| **Total outside liabilities/Tangible net worth (times)** | 0.9 | 0.7 | 0.6 |
| **Total debt/OPBDIT (times)** | 7.2 | 2.4 | 2.1 |
| **Interest coverage (times)** | 1.6 | 3.8 | 4.8 |

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation, *Provisional*

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

## Rating history for past three years

| | | Current rating (FY2025) | | | | Chronology of rating history for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | Instrument | Type | Amount rated (Rs. crore) | Date & rating in FY2025 | | Date & rating in FY2024 | Date & rating in FY2023 | Date & rating in FY2022 |
| | | | | Jul 24, 2024 | Jul 08, 2024 | - | - | - |
| 1 | **Issuer rating** | Long Term | - | [ICRA]A- (Stable) | [ICRA]A- (Stable) | - | - | - |
| 2 | **Term Loan** | Long Term | 1222.00 | [ICRA]A- (Stable) | - | - | - | - |
| 3 | **Commercial Paper** | Short Term | 50.00 | [ICRA]A2+ | - | - | - | - |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| **Issuer Rating** | NA |
| **Lt Fund-Based-Term Loan** | Simple |
| **St-Commercial Paper** | Very Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

## Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | **Issuer rating** | - | - | - | - | [ICRA]A- (Stable) |
| NA | **Fund-Based-Term Loan** | - | - | - | 1222.00 | [ICRA]A- (Stable) |
| Unplaced | **Commercial Paper** | - | - | - | 50.00 | [ICRA]A2+ |

*Source: Company*

*Please click here to view details of lender-wise facilities rated by ICRA*

## Annexure II: List of entities considered for consolidated analysis- Not applicable

## ANALYST CONTACTS

**Girishkumar Kadam**
+91 22 6114 3441
girishkumar@icraindia.com

**Prashant Vasisht**
+91 124 4545 322
Prashant.vasisht@icraindia.com

**Varun Gogia**
+91 98711 56542
varun.gogia1@icraindia.com

**Kushal Shah**
+91 79 4027 1527
kushal.shah@icraindia.com

## RELATIONSHIP CONTACT

**L. Shivakumar**
+91 22 6114 3406
shivakumar@icraindia.com

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**
Tel: +91 124 4545 860
communications@icraindia.com

## Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

## About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

## ICRA Limited

### Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

### Branches