

Directors' Report

FINANCIAL RESULTS

Your Directors have pleasure in presenting their First Annual Report and Audited Accounts of your Company for the period August 21, 2006 to December 31, 2006.

	Amount in Rupees	
	Cairn India Limited	Consolidated
Total income	59,064,909	449,632,050
Gross profit	–	305,400,011
Earnings before interest tax depreciation and amortisation	(290,526,584)	(6,677,921)
Profit/(loss) before tax	(292,240,985)	(130,130,717)
Profit/(loss) after tax	(292,240,985)	(186,557,677)

The above consolidated numbers include non-cash employee cost of Rs.345,058,813, depreciation, depletion and amortisation expenditure of Rs.61,225,521, unsuccessful exploration costs written off of Rs.59,480,772 and deferred tax of Rs.43,860,662. Profit before these items of charge is Rs.323,068,091.

Currently all operating assets are held by Cairn India Holdings Ltd through its subsidiaries. Cairn India acquired the Indian assets from Cairn UK Holdings Limited by acquiring majority ownership of Cairn India Holdings Ltd (including its subsidiaries) on December 20, 2006 and subsequently on December 29, 2006, acquired 100% ownership of Cairn India Holdings Ltd.

Since Cairn India was incorporated on August 21, 2006, the financial statements of Cairn India Limited have been prepared for the period August 21, 2006 to December 31, 2006 and the balance sheet has been prepared as at December 31, 2006. The Consolidated statements provide the results of Cairn India Limited together with those of its subsidiaries for the period December 20, 2006 (date of acquisition of majority ownership of Cairn India Holdings Ltd (including its subsidiaries)) to December 31, 2006. The consolidated statements incorporate the financial results for the relevant period in respect of all its 27 subsidiaries which are owned 100% by Cairn India Limited as at December 31, 2006. The consolidated results of Cairn India Limited are therefore not indicative of the financial performance of the entire Company along with its subsidiaries for the full year 2006.

DIVIDEND

This being the first year of operation for the Company, your Directors regret their inability to recommend any dividend.

OPERATIONS

Operations Review has been included in the Management Discussion and Analysis section which forms a part of this Annual Report.

EMPLOYEE STOCK OPTION SCHEME

The Company has established share incentive schemes pursuant to which options to acquire shares will be granted to select employees and Directors of Cairn India viz., Cairn India Senior Management Plan (CISMP), Cairn India Performance Option Plan (CIPOP) and Cairn India Employee Stock Option Plan (CIESOP).

During the year, stock options have been granted to the Executive Directors and employees of the Company. On exercising the options so granted, the paid-up equity share capital of the Company will increase by a like number of shares.

The details of stock options granted by the Company are disclosed in compliance with Clause 12 of the Securities Exchange Board of India (Employee Stock Options Scheme and Employee Stock Purchase Scheme), 1999 and set out in the Annexure to this Report.

SUBSIDIARY COMPANIES

During the year, your Company acquired all the shares of Cairn India Holdings Ltd (CIHL) and consequently CIHL has become a wholly owned subsidiary of the Company. CIHL is also a holding Company for 26 other companies. Consequently, all these Companies have become subsidiaries of your Company. Pursuant to the provisions of Section 212(8) of the Companies Act, 1956, the Company has obtained exemption from the Ministry of Company Affairs, New Delhi, vide its letter No 47/232/2007-CL-III dated May 25, 2007 to attach accounts of the subsidiaries. The accounts of the subsidiaries are available for inspection of members on any working day at the Registered Office of the Company between 10 am and 12 noon.

DIRECTORS

Sir William B.B. Gammell, Mr. Norman L. Murray, Mr. Hamish M. Grossart, Ms. Jann Brown, Mr. Rahul Dhir, Mr. Lawrence W. Smyth, Mr. Naresh Chandra, Mr. Aman Mehta, Dr. Omkar Goswami and Mr. Indrajit Banerjee were appointed as Additional Directors during the year. Pursuant to Section 260 of the Companies Act, 1956 they hold office up to this Annual General Meeting. The Company has received letters from some members of the Company sponsoring their candidature as Directors of the Company together with security deposit of Rs.500/- each.

Sir William B.B. Gammell, Mr. Norman L. Murray and Mr. Hamish M. Grossart would be appointed as non-rotational Directors. Mr. Rahul Dhir has been appointed as Managing Director and Chief Executive Officer with effect from August 22, 2006. Mr. Lawrence Smyth has been appointed as Executive Director and Chief Operating Officer with effect from March 1, 2007. Mr. Indrajit Banerjee has been appointed as Executive Director and Chief Financial Officer with effect from March 1, 2007.

Directors' Report – Continued

Mr. Malcolm Thoms was appointed as Alternate Director to Mr. Hamish M. Grossart at the Board meeting held on February 26, 2007.

Mr. Shardul Suresh Shroff, Ms. Bithika Anand and Mr. Piyush Joshi who were appointed as the first Directors of the Company ceased to be the Directors with effect from August 29, 2006 following their resignation from the Board. Ms. Jann Brown resigned as Director with effect from February 26, 2007. Your Directors wish to place on record their sincere appreciation of the valuable contribution made by Mr. Shroff, Ms. Anand, Mr. Joshi and Ms. Jann Brown during their tenure on the Board of the Company.

FINANCE

Initial Public Offering

In December 2006, Cairn India made an Initial Public Offering (IPO) of its equity shares. Post the successful completion of the IPO, Cairn India was, on January 9, 2007, listed on the National Stock Exchange and the Bombay Stock Exchange. Cairn India's Initial Public Offering of 328,799,675 equity shares was fully subscribed aggregating Rs.52,608 million at the issue price of Rs. 160. The Company also placed Rs.33,547 million in pre-IPO. The Company also exercised its Green Shoe Option for 13,085,041 shares. The Company now has a total share capital of 1,778 million shares and an investor base of over 300,000 shareholders. Cairn UK Holdings Limited owns 69% of the share capital, 10% is held by Petronas and 21% is held by institutional and individual shareholders.

CORPORATE GOVERNANCE

The Corporate Governance and Management Discussion and Analysis Report form an integral part of this Report and are set out as a separate section to this Annual Report. The Certificate of the Practising Company Secretary certifying compliance with the conditions of Corporate Governance as stipulated in Clause 49 of the Listing Agreement with Stock Exchanges is annexed with the report on Corporate Governance.

AUDITORS

M/s. S. R. Batliboi & Associates, Chartered Accountants, Auditors of the Company, retire at the conclusion of the ensuing Annual General Meeting and being eligible, offer themselves for re-appointment.

HUMAN RESOURCES

Company's industrial relations continued to be harmonious during the period under review.

PARTICULARS OF EMPLOYEES

Particulars of employees required to be furnished under Section 217(2A) of the Companies Act, 1956 forms part of this report. However as per the provisions of Section 219(1)(b)(iv) of the Act, the report and accounts are being sent to the shareholders of the Company excluding the particulars of employees under Section 217(2A) of the Act. Any shareholder interested in obtaining a copy of the said statement may write to the Company Secretary at the Registered Office of the Company.

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

Information on Conservation of Energy, Technology Absorption and Foreign Exchange Earnings and Outgo is given in the Annexure to this report.

DIRECTORS' RESPONSIBILITY STATEMENT

Pursuant to Section 217(2AA) of the Companies Act, 1956, the directors confirm that:

- i) in the preparation of the annual accounts, the applicable accounting standards have been followed along with proper explanation relating to material departures;
- ii) appropriate accounting policies have been selected and applied consistently and have made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Company as at December 31, 2006 and of the loss of the Company for the period August 21, 2006 to December 31, 2006;
- iii) proper and sufficient care has been taken for 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;
- iv) the annual accounts have been prepared on a going concern basis.

APPRECIATION

Your Directors express their gratitude to the Company's stakeholders, shareholders, business partners and suppliers for their understanding and support. Your Directors record their appreciation and gratitude to the banks for their continued and timely assistance in meeting the Company's resource requirement. Finally your Directors acknowledge the dedicated services rendered by all the employees of the Company.

For and on behalf of the Board of Directors

Place: Edinburgh
Date: July 30, 2007

Sir William B.B. Gammell
Chairman

Annexure to the Directors' Report

Disclosure pursuant to the provisions of Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

Cairn India Senior Management Plan (CISMP)

a	Options Issued	8,298,713	
b	The Pricing Formula	Rs.33.70 per share	
c	Options Vested	3,030,318	
d	Options Exercised	NIL	
e	The total number of shares arising as a result of exercise of option	NIL	
f	Options cancelled/forfeited	NIL	
g	Variation of terms options	NIL	
h	Money realized by exercise of option	NIL	
i	Total number of options in force as on December 31, 2006	8,298,713	
j	Employee wise details of options granted to:		
	i) Senior Managerial Person	Rahul Dhir – 6,714,233 Lawrence W. Smyth – 1,584,480	
	ii) Any other employee who receives a grant in any one year of option amount to 5% or more of options granted during the year.		NIL
	iii) Identified employees who were granted option during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the Company at the time of grant.		NIL
k	Diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of options calculated in accordance with International Accounting Standard (IAS) 33.		N/A
l	Method of calculation of employee compensation cost The company has calculated the employee compensation cost using the fair value of the stock options (Black Scholes option pricing model)		
	Difference between the employee compensation cost so computed at (l) above and the employee compensation cost that shall have been recognised if it had used the fair value of the options		NIL
	The impact of this difference on profits and on EPS of the Company		Amount (Rs. in million)
		Profit After Tax (PAT)	(Rs.292.241)
		Less: Additional employee Compensation cost based on fair value	NIL
		Adjusted PAT	(Rs.292.241)
		Adjusted EPS Basic	(Rs.0.94)
		Diluted	(Rs.0.94)
m	Weighted-average exercise price and fair value of Stock Options granted:		
	Stock Options Granted on	Weighted average exercise price (in Rs.)	Weighted average Fair value (in Rs.) Face Value Rs 10/-
	November 24, 2006	33.70	131.50
			Closing market price at NSE on the date of grant (in Rs.) Cairn India Limited was not listed on grant date

Annexure to the Directors' Report – Continued

- n** Description of the method and significant assumptions used during the year to estimate the fair value of the options, including the following weighted average information:

The Black Scholes option pricing model was developed for estimating fair value of traded options. Since Option pricing model require use of substantive assumptions, changes therein can materially affect fair value of options. The option pricing models do not necessarily provide a reliable measure of fair value options.

The main assumptions used in the Black-Scholes option pricing model during the year were as follows:

Risk free interest rate	6.62% to 7.41%
Expected life of options from the date of grant	Upto 4.1 Years
Expected Volatility	38.17% to 54.12%
Expected Dividend yield	
Industry average	Not considered
Cairn India	NIL

Calculation of Fair Value based on Black Scholes Model

ASSUMPTIONS:

Risk Free Interest rate	6.62% to 7.41%	
Expected life of option (Vesting period of the option)	Upto 4.1 Years	
Expected Volatility	38.17% to 54.12%	
Previous year the rate was 25% based on peer group. In the current year expected volatility in the company has been considered.		
Stock Price (Closing Price of share on NSE on date of the grant)	Date of grant 24-11-06	Price (Rs) Not Listed
Exercise Price (Grant Price of the Option as per the information furnished)	Date of grant 24-11-06	Price (Rs) 33.70
Dividend yield rate (Based on Company's dividend policy as well as the estimated dividend yield of certain companies of the Oil & Gas Industries during FY 2006)	Industry average Cairn India	Not considered (NIL)
Employee compensation cost using the Valuation as per Black Scholes Model	Date of grant 24-11-06	Fair value (Rs per share) 131.50

Conclusion:

CISMP

Employee compensation cost for Cairn India Senior Management Plan (CISMP) of the Company using the Black Scholes method of stock option is estimated at Rs. 1,091 million for the options, which are granted during the financial year 2006 (Rupees One Thousand and ninety one million.)

Annexure to the Directors' Report – Continued

Cairn India Performance Option Plan (2006) (CIPOP)

a	Options Issued		1,708,195
b	The Pricing Formula		Rs. 10 per share
c	Options Vested		NIL
d	Options Exercised		NIL
e	The total number of shares arising as a result of exercise of option		NIL
f	Options cancelled/forfeited		NIL
g	Variation of terms options		NIL
h	Money realised by exercise of option		NIL
i	Total number of options in force as on December 31, 2006		NIL
j	Employee wise details of options granted to:		
	i) Senior Managerial Person		
	Rob Theriault	60,012	Rolf Stork 53,034
	Jon Hafsmo	68,406	John McNeill 65,670
	David Nisbet	98,505	P Elango 42,142
	Indrajit Banerjee	87,811	
	ii) Any other employee who receives a grant in any one year of option amount to 5% or more of options granted during the year.		NIL
	iii) Identified employees who were granted option during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the Company at the time of grant.		NIL
k	Diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of options calculated in accordance with International Accounting Standard (IAS) 33.		N/A
l	Method of calculation of employee compensation cost The Company has calculated the employee compensation cost using the fair value of the stock options.		
	Difference between the employee compensation cost so computed at (l) above and the employee compensation cost that shall have been recognised if it had used the fair value of the options.		NIL
	The impact of this difference on profits and on EPS of the Company		Not applicable since Options were granted in 2007
m	Weighted-average exercise price and fair value of Stock Options granted		Not applicable since Options were granted in 2007
n	Description of the method and significant assumptions used during the year to estimate the fair value of the options		Not applicable since Options were granted in 2007

Annexure to the Directors' Report – Continued

Cairn India Employee Stock Option Plan (2006) (CIESOP)

a	Options Issued	3,467,702	
b	The Pricing Formula	In the case of the Initial Grant, the issue price as ascertained in the floatation and for other Options such price as determined by the Remuneration Committee (in any event not being less than the fair market value of a Share on the date of grant).	
c	Options Vested	NIL	
d	Options Exercised	NIL	
e	The total number of shares arising as a result of exercise of option	NIL	
f	Options cancelled/forfeited	NIL	
g	Variation of terms options	NIL	
h	Money realised by exercise of option	NIL	
i	Total number of options in force as on December 31, 2006	NIL	
j	Employee wise details of options granted to		
	i) Senior Managerial Person.		N/A
	ii) Any other employee who receives a grant in any one year of option amount to 5% or more of options granted during the year.		NIL
	iii) Identified employees who were granted option during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the Company at the time of grant.		NIL
k	Diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of options calculated in accordance with International Accounting Standard (IAS) 33.		N/A
l	Method of calculation of employee compensation cost		
	The Company has calculated the employee compensation cost using the fair value of the stock options.		
	Difference between the employee compensation cost so computed at (l) above and the employee compensation cost that shall have been recognised if it had used the fair value of the options.		NIL
	The impact of this difference on profits and on EPS of the Company	Not applicable since Options were granted in 2007	
m	Weighted-average exercise price and fair value of Stock Options granted	Not applicable since Options were granted in 2007	
n	Description of the method and significant assumptions used during the year to estimate the fair value of the options	Not applicable since Options were granted in 2007	

Conservation of Energy, Technology Absorption, Foreign Exchange Earnings and Outgo

CONSERVATION OF ENERGY

Energy conservation measures taken

Our focus on the impact of our operations on climate change leads to our energy conservation strategy where we can best evaluate our performance through measurement of emissions to the atmosphere.

As part of our climate change strategy, we have been monitoring and setting targets for both methane and GHG emissions since 2000, and have implemented several initiatives to reduce these emissions including the installation of high efficiency flares, third stage compression and improving plant operations to minimise volumes of gas flared during plant upsets.

These emissions to air from our production plants are primarily due to combustion of produced gas for power generation and some heating of crude oil to aid water separation as well as maintaining a small flare for safety reasons.

For 2006 we set a target to maintain or reduce our methane emissions from our producing fields (normalised to per unit tonne of hydrocarbon produced) and to maintain GHG emissions (normalised to per unit tonne of hydrocarbon produced) within 10% of the level recorded in 2005. In 2006, we have seen a slight increase in methane production per unit production of hydrocarbon. The increase is principally due to an increase in emissions at Suvali as a result of flaring of low pressure gas to handle the commencement of oil production in 2006. Mitigating measures for reduction of GHG emissions have been initiated.

Additional investments and proposals being implemented for reduction of consumption of energy

Mitigation measures for reduction of GHG in 2007 have been initiated. We plan to reduce flaring at Suvali in 2007 and we propose to carry out an energy audit in Suvali and Ravva with the aim of identifying opportunities to achieve further gains in energy efficiency in the longer term.

Impact of the above measures for reduction of energy consumption and consequent impact on the cost of production

Total energy consumption has decreased this year as a result of the decrease in drilling activity in Rajasthan. However, energy consumption normalised to hydrocarbon production has decreased by 10% to 0.44 GJ/tonne in 2006. This compares to the OGP industry average last published for 2005 of 1.40 GJ/tonne.

TECHNOLOGY ABSORPTION

Research and development (R&D)

Specific areas in which R&D was carried out by the Company

Cairn India initiated laboratory studies on core and fluid samples from the Mangala Field which are specifically related to developing Enhanced Oil Recovery (EOR) techniques appropriate for the field. This will be extended to the Bhagyam and Aishwariya fields in 2007 when the Company is planning to join a joint industry research project looking at new methods and chemicals for possible application in EOR schemes for Mangala, Bhagyam and Aishwariya.

Responding to the conclusions of a review of best practice in biodiversity assessment and management conducted in 2005, Cairn India adopted a 'no net loss' policy on biodiversity in 2006. This has been included in our policies and guiding principles.

In addition, we further developed our methodology for evaluating biodiversity importance and sensitivity. This methodology was tested during the assessment of new licence blocks in India and identified those areas requiring more rigorous assessment of biodiversity importance.

In Rajasthan, we commissioned the Arid Forest Research Institute to conduct a biodiversity baseline study. The aim of the study is to map the existing biodiversity around our proposed development sites and suggest measures for conservation and sustainable use. The study will be conducted over two years. The first level of field monitoring during the winter season has been completed.

In Ravva we also produce all of our fresh water from desalination of saline water and make no direct use of local fresh water supplies. We expect to use a similar process to supply our fresh water needs in Rajasthan once we have completed the development and construction phases of the project.

We have engaged the National Geo-physical Research Centre (NGRI), a reputed Government of India institute, to assess the impact on the ground water with regard to salinity changes, draw down, subsidence and any other impacts due to continuous ground water withdrawal near the coastline around Ravva. The study area will cover about 250 km² and will be implemented over two years. The geological field surveys commenced in June 2006.

Conservation of Energy, Technology Absorption, Foreign Exchange Earnings and Outgo – Continued

Benefits derived as a result of the above R&D

Cairn India's research into EOR applications for Mangala, Bhagyam and Aishwariya has the potential to unlock additional oil reserves within these fields and a long term strategy for EOR is being developed with this end in mind.

Improved understanding of biodiversity in locations proposed for operations and a management programme to reduce the impact on biodiversity from our activities.

Future plan of action

We will continue to investigate and optimise chemical EOR schemes for Cairn India's Rajasthan fields in the laboratory before initiating one or more field-scale demonstration projects once production has commenced. In addition in 2007 Cairn will join the joint industry research project on chemical EOR at the University of Texas, Austin. This project is screening new chemical types for EOR, developing improved simulation techniques to predict EOR field results as well as conducting laboratory tests in support of these objectives.

Our activities produce emissions to air, including methane and carbon dioxide – two gases recognised as greenhouse gases (GHG). As such we are working to increase our understanding of climate change and its competitive and financial implications and the measurement of these implications. The Kyoto Protocol, inter-alia, provides India with the opportunity and incentive to control the growth of emissions through the Clean Development Mechanism (CDM). We have therefore been exploring the application of the CDM to our Mangala Development in Rajasthan. Projects being explored involve the use of associated gas for power thereby avoiding flaring and the capture and re-injection of flue gases from turbines. During 2006 we have conducted further research including more detailed financial analysis to ascertain the feasibility of emission reduction projects and their possible qualification under the Clean Development Mechanism (CDM) rules. Initial discussions have also been held with the Indian Designated Authority.

Expenditure on R&D		Amount in Rupees
i)	Capital	1,324,805*
ii)	Recurring	191,250*
iii)	Total	1,516,055
iv)	Total R&D expenditure as a percentage of total turnover	N/A#

* These are consolidated numbers for the full year ended December 2006.

Cairn India Limited acquired the majority ownership of Cairn India Holdings Ltd (including its subsidiaries) on December 20, 2006. Turnover included in the Consolidated Financial Statements is for the period December 20, 2006 to December 31, 2006.

For and on behalf of the Board of Directors

Place: Edinburgh
Date: July 30, 2007

Sir William B.B. Gammell
Chairman