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AN ANLYSIS ON FINANCIAL AND CAPITAL STRUCTURE OF OIL AND GAS INDUSTRY - A CASE STUDY OF ONGC VIDESH LIMITED

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Abstract: *The Indian Oil and Gas (O&G) sector is one of the six core industries of India and contributes over 15 per cent to the Gross Domestic Product (GDP). The country is the sixth largest consumer of oil in the world and the ninth largest crude oil importer. The sector is of immense importance to the economy owing to its significant forward integration with many other sectors. India is committed to boosting its growth in the years to come and this progress would translate into the country's energy needs growing many times. Under new exploration licensing policy (NELP) ONGCVL has to compete with private sector companies for obtaining petroleum exploration license, which was almost a monopoly for ONGCVL till recently. Under such circumstance, ONGCVL has to be care full and at the same time aggressive to cease the opportunity available by taking quick and prompt decision. In order to maintain the profit growth as well as business growth, National Oil Companies have now to focus more on volume growth of various products as well as to attempt significant cost reduction so as to sustain competitive edge and lead position. In the changing scenario the role of finance is shifting from controlling to influencing where finance plays an equally important role as business partner providing valuable information support to the operating managers which will facilitate taking more prudent decisions by the operating managers so that there is increasing value to the business from such decisions. The financial structure decision is a continuous one and has to be taken whenever a firm needs additional finances.Keeping the above facts this paper proposes to analyse the financial and capital structure in oil and gas industry with specific reference to ONGC Videsh Limited(ONGCVL).*

Keywords: Financial Structure, Capital Structure, Short-term and Long-term Funds, Structural Ratios, Coverage Ratios, Debt Ratios

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1.INTRODUCTION:

The word 'structure', originated from the field of engineering, means different parts of a building. Similarly, financial structure consists of three elements namely assets, liabilities and capital.

Financial structure refers to the way; the firm's assets are financed. It is the entire left-hand side (liabilities plus equity) of the balance sheet which represents all the long-term and short term sources of capital.

Capital structure refers to the mix of long-term sources of funds, such as debentures, long-term debt, preference share capital and equity share capital including reserves and surpluses (i.e. retained earnings). It is only a part of financial structure. If short-term liabilities are added in capital structure, it becomes financial structure. Thus, capital structure refers to that part of the financial structure which represents long-term sources. (Khan,M.Y and .Jain,P.K, 1992)[5]

To confine the real area of the term 'capital structure', it is necessary to distinguish it from the term 'assets structure'. Assets Structure refers to the 'makeup' of total assets as represented by fixed assets and current assets. It is right hand side of the balance sheet which represents total capital employed in the business.

However it should be noted here, that Wesel H., (1991)[8] has used the term 'capital structure' and 'financial structure' interchangeably. According to him financial structure also refers to the make-up of the permanent capital of the firm.

Task of formatting financial structure involves the decisions regarding the type of securities to be issued and the relative proportion of each type of security namely shares, debentures, retained earnings etc. in the total capitalization. Each corporate security has got its own advantages and disadvantages. Hence, too much induction of one security in the capital structure may prove unprofitable or risky. For instance, if capital structure mainly comprises of equity capital and having inadequate debt capital, it may deprive of the benefits of trading on equity and hence may not fulfill the objective of maximum return to its owners. On the other hand, if a company, with fluctuating income, has high capital leverage having grater risk, then such capital structure will maximize return to owners. However, in lean years the position of a firm may be very critical because the net income might not be enough to meet even the fixed charge obligations on preference shares or debentures.

There is not a single capital structure which is suitable to all types of business. Whether or not, a capital structure is suitable for a particular business depends upon the circumstances and nature of business. The capital structure should be framed in such a way that it maximises returns to its owners.

In this backdrop the researcher has decided to analyse the financial and capital structure of Oil and Gas Industry with reference to ONGC Videsh Limited through trend analysis and ratio analysis based on the financial information.

2. RESEARCH METHODOLOGY

2.1 Review of Literature:

A number of research studies have been carried out on different aspects of financial performance of different industries by the researchers, economists and academicians in India and abroad. Different authors have analyzed performance in different perspectives. A review of these analyses is important in order to develop an approach that can be employed in the context of the study of Indian oil and gas industry.

Dr. Sunita panicker (2013)[2] advocates that better performance and sustainability in operation is achieved with the help of Capital Structure. Though there are many factors which affects the performance of firms, capital structure plays a major role in determining sustained performance of a sector. So it's important to know the factors which contribute to the firm's capital structure.

Amidu (2011)[1] stated that the factors to be considered whenever a capital structure decision is taken are: Capital Intensity, Tangibility, Profitability, firm Size, Non Debt Tax Shield based on

Huang (2010)[3] suggested that the company may need funds to finance its activities continuously. Every time the funds have to be procured, the financial manager weighs the pros and cons of various sources of finance and selects most advantageous sources keeping in view the target capital structure: Thus the capital structure decision is a continuous one and has to be taken whenever a firm needs additional finance

As stated by Zeitun, R. and Tian, G. (2008),[9] a demand for raising funds generates a new financial structure since a decision has to be made as to the quantity mix has its implications on the share holders earning and risk, which in turn will affect the market the market value

of the firm. Thus, the primary motive of a company in using different capital mix is to magnify the shareholders earnings and thereby market value of the firm.

As stated by Jensen (2006),[4] once a company has been formed and it has been in existence for some years, the financial manager then has to deal with the existing capital structure.

According to James (2004)[7] financial structure decisions is a significant managerial decision as it influences the shareholder's return and risk. Consequently the market value of the share is affected by the financial structure decision.

Santimoy Patra (2002)[6] stated that the search for optimum financial structure is like search for truth or wisdom.The financial structure of a firm is very important since it related to the ability of the firm to meet the needs of its stakeholders.

Survey of the existing literature indicates that enough research has not been carried on to anayse the financial and capital structure in Oil and Gas Industry during post reforms period. The present study is a humble attempt in this regard.

2.2 Statement of the Problem:

There have been many studies, glorifying the problems and prospects of ONGCVL from different dimensions, but surprisingly a comprehensive study is missing in the area of financial management and accounting in ONGCVL. Keeping in view the strategic role of finance and its allied aspects in the promotion and development of oil industry, an attempt has been made in this study to analyze the practices of financial management and accounting adopted by ONGCVL.

The present study, therefore strives to bridge the gap by focusing attention on important aspects of financial management and accounting practices. Such a comprehensive study regarding this area is the need of the hour and present study has been undertaken with a view to fill this gap.

2.3 Need for the Study:

Financial appraisal provides a method for assessing the financial strengths and weaknesses of the ONGC Videsh Limited using financial statements. These are two views of the financial strength of every organization based on the period of lending i.e., the short term and long term. The short-term financial strength relates to the technical solvency of an organization in the near future, while the long-term financial strength depends on the structure that has been imposed in financing more permanent assets requirements. The present study is made

to analyze the short-term and long-term financial strength of the Indian Oil and Gas Industry after liberalization.

2.4 Scope of the Study:

The scope of the research area is confined to one of the key issues of finance i.e. analysis and interpretation of financial and capital structure aspects. The study has been confined to mainly for the computation of required ratios to analyse the financial and capital structure. This micro research of information gives scope to analyses the financial aspects to arrive at appropriate decisions by top management, investors and concerned parties.

2.5 Objectives of the Study:

The Study has the following specific objectives.

1. To analyse financial structure of ONGC Videsh Limited.
2. To evaluate the capital structure of ONGC Videsh Limited and
3. To suggest an appropriate strategy for improvement of financial soundness of ONGC Videsh Limited

2.6 Methodology:

The study is based on secondary data, which was derived from the published annual reports of ONGC Videsh Limited, which are collected from the registered office of ONGC Videsh Limited. In addition to published reports, other publications by ONGC Videsh Limited were also used. The information related to the transport industry is derived from various sources like articles, journals, periodicals, newspapers etc. The collected data was analyzed using relevant Statistical and Accounting Techniques.

2.7 Period of the study:

The period 2002-2003 to 2011-2012 is selected for this study. This 10 year period was chosen in order to have a fairly long, cyclically well balanced period, for which reasonably homogeneous, reliable and up-to-date financial data would be available.

3. PROFILEOF ONGC VIDESH LIMITED:

ONGC Videsh Ltd. (OVL), a wholly owned subsidiary of Oil and Natural Gas Corporation Ltd. (ONGC) was rechristened on 15th June, 1989 from the erstwhile Hydrocarbons India Pvt. Ltd. which was incorporated on 5th March, 1965. The authorised and paid-up share capital of ONGC Videsh as on 31st March, 2012 stood at `5,000 crore. The primary business of the company is to prospect for oil and gas acreages abroad, which includes acquisition of oil and

gas fields in foreign countries as well as exploration, production, transportation and sale of oil and gas.

ONGC Videsh is an Indian company which focuses on the exploration, development, production, transportation and export of oil and gas, and the acquisition of oil and gas fields. It mainly prospects for oil and gas acreages abroad. ONGC has total oil and gas reserves of 406.77Mmt oil equivalent with a crude oil production of 6.556Mmt and a natural gas output of 2.220Bmt. ONGC Videsh has developed strong relationships with National/ International Oil Companies of various countries by working with their team and management at project level. Some of the leading alliance partners of are ExxonMobil, British Petroleum, Shell, ENI, Total, Repsol, Statoil, Chevron, Petrobras, Sodeco, Socar, Rosneft, Kazmunaigaz (KMG), Petro Vietnam, CNPC, Sinopec, PDVSA, TPOC, Petronas and Ecopetrol.

4. ANALYSIS OF FINANCIAL AND CAPITAL STRUCTURE OF ONGCVL:

The overall financial structure of the ONGCVL can be studied from the view point of time duration(short term and long term funds), ordinary shareholders(extent of capital gearing) and relative contribution of owners and creditors(trading on equity). The following analysis was carried out to analyze financial structure of ONGCVL.

A. Trend Analysis

B. Ratio Analysis

A. Trend Analysis:

The financial structure can be analyzed from the quantum of long term and short-term funds as percentage of total assets of ONGCVL. In ONGCVL, long-term funds include equity capital and long term funds. While short-term funds include provisions, deposits with S.T, sundry creditors and advances from customers. The following analysis was carried out to find out financial structure trend in ONGCVL

1. Short Term Funds Trend Analysis
2. Long Term Funds Trend Analysis
3. Quantum of Short Term and Long Term Funds as percentage of Total Assets

1. Short Term Funds Trend Analysis

Table 4.1

Trend of Short Term Fund (in Percentage) (Base Year 2002-03) in ONGC Videsh Limited from 2002-3 to 2011-12

(Rs. In crores)

Year	Creditors	Depo-sits	Advances from	Provis-ions	Short Term	Total Assets	STF as %	Trend
2002-03	419.38	0.04	150.00	1.29	570.71	8308.56	6.87	100.00
2003-04	668.28	0.06	150.00	1.71	820.05	10623.52	7.72	112.37
2004-05	862.79	0.10	0.00	122.57	985.46	14294.44	6.89	100.29
2005-06	1176.19	0.09	5.49	5.22	1186.99	20895.10	5.68	82.68
2006-07	1862.64	2.56	8.32	11.00	1884.52	20919.08	9.01	131.15
2007-08	2357.62	8.63	12.95	27.10	2406.30	21393.81	11.25	163.76
2008-09	4752.82	0.13	16.65	45.64	4815.24	38978.32	12.35	179.77
2009-10	4456.39	11.39	13.21	42.60	4523.59	38591.59	11.72	170.60
2010-11	5180.1	10.92	16.10	52.92	5260.04	43593.29	12.07	175.69
2011-12	7102.03	11.53	76.56	18.93	7209.05	50600.66	14.25	207.42
Average	**2883.82**	**4.55**	**44.928**	**32.90**	**2966.20**	**26819.84**	**9.781**	**142.37**

Source: Computed from the annual reports and accounts of the ONGCVL

Table 4.1 reveal that in ONGCVL, short term funds include four main components. They are creditors, deposits with ST, advances from customers and provisions. From above data, it is apparent that deposits with ST have the minimum share of 0.15% in the short term funds of the organization, whereas, sundry creditors (income earned but not received, interest due but not received, debts from other companies etc.) have the biggest contribution of around 97% to the short term funds.

Thus, short term funds of ONGCVL mainly comprise of sundry creditors. As such, the trend of short term funds is largely followed by the trend of sundry creditors in ONGCVL.

Table 4.1 also reveal that Short Term Fund to total assets in ONGCVL shows increasing trend except in the year 2005-06. It ranged between 82.68 per cent in the year 2005-06 and 207.42 per cent in the year 2011-12 with an average trend of 142.37 per cent.

Though, Short Term Fund in ONGCVL shows increasing trend during the study period, it was lower than average up to 2006-07 thereafter it was more than the average trend till the end of the study period.

2. Long Term Funds Trend Analysis

Table 4.2

Trend of Long Term Fund (as % of Total Assets) (Base Year 2002-03) in ONGC Videsh Limited from 2002-3 to 2011-12

(Rs. In crores)

Year	Equity	Loan Funds	Long term fund	Total Assets	LTF as % of TA	Trend
2002-03	509.63	7053.40	7563.03	8308.56	91.03	100.00
2003-04	871.99	8758.05	9630.05	10623.52	90.65	99.58
2004-05	1222.69	11661.01	12883.70	14294.44	90.13	99.01
2005-06	2197.74	15924.18	18121.93	20895.10	86.73	95.28
2006-07	4373.56	13234.75	17608.32	20919.08	84.17	92.46
2007-08	6305.90	11373.77	17679.67	21393.81	82.64	90.78
2008-09	11515.55	20679.01	32194.56	38978.32	82.60	90.74
2009-10	11644.89	20698.28	32343.18	38591.59	83.81	92.07
2010-11	14552.97	20590.70	35143.67	43593.29	80.62	88.56
2011-12	19941.11	19516.10	39457.21	50600.66	77.98	85.66
Average	**7313.60**	**14948.93**	**22262.53**	**26819.84**	**85.04**	**93.41**

Source: Computed from the annual reports and accounts of the ONGCVL

Table 4.3

Average of Components of Long term funds of ONGC Videsh Limited from 2002-03 to 2011-12

(Rs. in crores)

Particulars	Average	Percentage
Equity	7313.603	32.85
Loan Funds	14948.93	67.15
Total	22262.53	100.00

Table 4.2, 4.3 reveal that in ONGCVL, long term funds include two main components. They are equity and loan funds. From above data, it is apparent that Equity (Equity share capital, reserves and surplus) have the share of 32.85% in the long term funds of the organization, whereas, loan funds (long term debts) have the biggest contribution of around 67% to the long term funds.

Table 4.2 also reveal that Long Term Fund to total assets in ONGCVL shows decreasing line except in the year 2009-10. It ranged between 77.98 per cent in the year 2011-12 and 91.03 per cent in the year 2002-03 with an average of 85.04 per cent.

The trend of Long Term Fund to total assets in ONGCVL was higher in the year 2002-03 with 100 per cent and lower in the year 2011-12 with 85.66 percent. Also it was higher than average from 2002-03 to 2005-06 and lower than the average from 2006-07 to till the ending year of the study period. The amount of long term funds are increasing year to year due to increase in reserves and long term debts. The amount of long term debts increased by 176.69 percent from 2002-03 to 2011-12. It was 7053.40 crores in 2002-03 and increased to 19516.10 crores by 2011-12. Hence long term funds as percentage of total assets was more than 80 percent throughout the study period. It represents the major sources for acquiring of fixed assets raised through long term debts.

3. Quantum of Short Term and Long Term Funds as Percentage of Total Assets:

Table 4.4

Quantum of Short Term and Long Term Fund (as % of Total Assets)

From 2002-03 to 2011-12 in ONGC Videsh Limited

(Base Year 2002-03)

(Rs. In crores)

Sr. No.	Year	Short Term Funds	Long term fund	Total Assets	SF as % of TA	LTF as % of TA
1.	2002-03	570.71	7563.03	8308.56	6.87	91.03
2.	2003-04	820.05	9630.05	10623.52	7.72	90.65
3.	2004-05	985.46	12883.70	14294.44	6.89	90.13
4.	2005-06	1186.99	18121.93	20895.10	5.68	86.73
5.	2006-07	1884.52	17608.32	20919.08	9.01	84.17
6.	2007-08	2406.30	17679.67	21393.81	11.25	82.64
7.	2008-09	4815.24	32194.56	38978.32	12.35	82.60
8.	2009-10	4523.59	32343.18	38591.59	11.72	83.81
9.	2010-11	5260.04	35143.67	43593.29	12.07	80.62
10.	2011-12	7209.05	39457.21	50600.66	14.25	77.98
Average		**2966.20**	**22262.53**	**26819.84**	**9.78**	**85.04**

Source: Computed from the annual reports and accounts of the ONGCVL

Table 4.4 reveal that long term funds have the average share of 85% in the total assets of the company, whereas, short-term funds have the lowest contribution of around 10% to the

total assets the remaining 5% belongs to fictitious and intangible. Thus, total assets of ONGCVL mainly financed by long term funds.

B. RATIO ANALYSIS

The capital structure ratios reflect the long-term financial strength/solvency of a firm (Zeitun, R. and Tian, G., 2007)[6]. There are mainly two aspects of long term solvency of a firm i.e., (i) ability of a firm to repay the principal when due and (ii) regular payment of the interest which can be examined by structural and coverage ratios respectively.

Coverage ratios are based on relationship between debt servicing commitments and the sources for meeting these burdens. The important coverage ratios are Interest Coverage Ratio, Dividend Coverage Ratio, Total Fixed Charges Coverage Ratio, Cash Flow Coverage Ratio and Debt Services Coverage Ratio.

Several ratios may be used to analyze long-term solvency of a firm. Following are some of the important ratios calculated for analyzing capital structure of ONGCVL

Structural Ratios:

Structural ratios are based on the relationship between borrowed fund and owner's capital. The important structural ratios are Debt-Equity Ratio, Debt- Assets Ratio and Equity-Assets Ratio.

1. Long term Debt-Equity Ratio
2. Total Debt-Equity Ratio
3. Total Debt-Total Assets Ratio
4. Proprietary Ratio

Coverage Ratios

5. Interest Coverage Ratio

Other Debt Ratios

6. Financial Leverage Ratio
7. Net Fixed Assets-Net Worth Ratio
8. Fixed Assets-Long Term Debt Ratio

Table 4.5

Structural Ratio of ONGC Videsh Limited From 2002-03 to 2011-12

(Rs. In crores)

Sr. No.	Year	Long Term Debt-Equity Ratio	Total Debt-Equity Ratio	Total Debt-Total Assets Ratio	Propr-ietary Ratio (%)	Interest Coverage Ratio	F.L Ratio	NFA/ NW Ratio	FA/ LTD Ratio
1.	2002-03	13.84:1	14.96:1	0.92:1	6.13	31.11:1	1.27:1	2.81:1	0.20:1
2.	2003-04	10.04:1	10.98:1	0.90:1	8.21	133.49:1	1.13:1	1.46:1	0.15:1
3.	2004-05	9.54:1	10.34:1	0.88:1	8.55	1165.75:1	1.02:1	0.98:1	0.10:1
4.	2005-06	7.25:1	7.79:1	0.82:1	10.52	401.3:1	0.94:1	0.78:1	0.11:1
5.	2006-07	3.03:1	3.46:1	0.72:1	20.91	85.2:1	0.92:1	1.16:1	0.38:1
6.	2007-08	1.80:1	2.19:1	0.64:1	29.48	6.99:1	1.27:1	0.72:1	0.40:1
7.	2008-09	1.80:1	2.21:1	0.65:1	29.54	8.59:1	1.17:1	0.35:1	0.20:1
8.	2009-10	1.78:1	2.17:1	0.65:1	30.17	9.55:1	1.04:1	0.41:1	0.23:1
9.	2010-11	1.41:1	1.78:1	0.59:1	33.38	14.7:1	1.05:1	0.29:1	0.21:1
10.	2011-12	0.98:1	1.34:1	0.53:1	39.41	17.85:1	1.04:1	0.18:1	0.18:1
Average		5.15	5.72	0.73	21.63	187.45	1.08	0.91	0.22
SD		4.63	4.90	0.14	12.32	364.45	0.12	0.78	0.10
CV%		89.93	85.63	19.05	56.97	194.42	11.10	85.63	46.99
Compound Annual Growth Rate %		-25.50	-23.51	-5.95	22.96	5.99	-2.21	-26.35	-1.15

Source: Computed from the annual reports and accounts of the ONGCVL

1. Long term debt to equity ratio in ONGCVL has varied from 13.84 times in 2002-03 to 0.98times in 2011-12. It is observed from the declining trend of ratio that funds in long term debt are reduced by ONGCVL year after year. Decreasing trend in Long-term debt to equity ratio indicates that the ONGCVL has been gradually depending on equity capital than the long term debts over the time.
2. The total debt to equity ratio of ONGCVL was 14.96 times in the year 2002-03, which indicates the firm has been financed by outsider's funds rather than owners funds, but the ratio was reduced to 1.34 in the year 2011-12 which indicates that the firm has been financed by owner funds rather than outsider's funds. It's a good sign to ONGCVL.

3. The debt to assets ratio of ONGCVL ranged between 0.92 times in the year 2002-03 and 0.53 times in the year 2011-12 with an average ratio of 0.73 times, which indicates that in ONGCVL total assets exceeds debts and for every 0.73paisa of outside liability, the ONGCVL has Re.1 of total assets with a compound annual growth rate of -5.95 percent. Decreasing trend of ratio indicates that, the ONGCVL gradually reducing its dependence on outsider's funds for financing of its total assets. In the long run, ONGCVL more stable because of the lower dependence on outside funds.
4. Proprietary ratio of ONGCVL ranged from 6.13 percent to 39.41 percent during the study period 2002-03 to 2011-12. the increasing trend of this ratio indicates the ONGCVL gradually raising its dependence on owner's funds and reducing its dependence on outsider's funds for financing its total assets. Thus, the capital structure of the ONGCVL is in a sound position and is stable in the long run.
5. The interest coverage ratio of ONGCVL reveals the better capacity of the firm in making the payment of interest as well as greater the safety during the study period.
6. The Financial Leverage Ratio ranged between 0.92 times in the year 2006-07 and 1.27 times in the year 2002-03 with an average ratio of 1.08 times. The ratio was not much high during whole study period. It indicates that the ONGCVL has been enjoying the benefits of trading on equity and was improving over the time as the ratio is decreasing from last half decade.
7. The Net Fixed Assets-Net worth Ratio of ONGCVL shows decreasing trend during the study period from 2002-03 to 2011-12 except in the year 2006-07. The capital structure of the ONGCVL is sound from last half decade. It depends on shareholders' funds for financing its fixed assets instead of depending on outside funds.
8. The Fixed Assets to Debt Ratio reveals that the long term debt of company have hype of 176.69% and on the other hand, net fixed assets has hype of 149.35% during the study period. It indicates that the fixed assets have not provided sufficient securities to long term fund and they can be said to be unsecured by the fixed assets of the ONGCVL during the tenure.

CONCLUSION:

Financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. In the present study financial health of ONGCVL is measured through financial and capital structure analysis. Various accounting, statistical and mathematical techniques are used for the analysis.

ONGCVL has been treated as one of the most successful organisation in the country, as it has been making profits consistently. In the year 2011-12, ONGCVL has made an ever highest profit of Rs. 2721.15 crores. Increasing revenue is the main source of such profit and revenue from the sales of crude oil is the major part of total revenue of ONGCVL.

It can also be concluded from the fore given analysis that the debt dependence was less in ONGCVL when compared with 2002-03 to sustain a growth and maintain profitability trend, ONGCVL has repaid loans worth or Rs. 19516.10 crores taking the debt equity ratio to an all time low 0.98 percent by the year ended 2011-12.

OVL is focused to support India's oil and gas security through overseas participation in oil and gas Exploration and Production activities. As per ONGC Group's Perspective Plan 2030, OVL's oil and gas production should increase from the existing level of 7.26 MMToe to 20 MMToe by 2017-18 and 60 MMToe by 2029-30. This translates to a CAGR of 22.5% during 5 years till FY'18 and 9.5% during FY'18 to FY'30. The emerging industry landscape augurs well for the company as it evolves into a leading New Multinational Oil Company (NMOC). As a NMOC, the company is positioning itself to be a key ONGC growth vehicle by aiming for 60MMTOE production by 2030.

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