

Audit Committee Report

Carol Chesney
Chair of the
Audit Committee



“Hunting’s key trading markets continued to report subdued economic activity during most of 2021, which led to drilling and equipment purchasing remaining lower than anticipated. In 2020, the first quarter was relatively unaffected by the COVID-19 pandemic, which had the overall effect of supporting Hunting’s full-year result, and included a positive trading EBITDA. In 2021, the Group’s trading EBITDA reported a small positive result, due to the ongoing subdued trading conditions throughout most of the Group, although the Hunting Titan operating segment did report improved results in H2 2021 as the US onshore market returned to growth.

The work of the Audit Committee and Board therefore focused on the review of the Group’s monthly trading results as management continued its efforts to reduce inventories to generate cash. The year-end cash and bank position of \$114.2m supports the excellent achievements of management during, what has been, a difficult year. As part of the preparations for the year-end audit, the Committee were also briefed on inventory valuation and provisioning procedures, given the subdued trading of certain product lines.

The Committee continued to review reports on the Group’s Going Concern assumption ahead of its half-year and full-year results and in the year received reports on various trading scenarios to support the Going Concern and Viability Statements contained within the 2021 Annual Report and Accounts. With the securing of a new \$150m Asset Based Lending facility in February 2022, the liquidity position of the Group has significantly improved, which has supported the Group’s Going Concern and Viability assumptions at year-end.”

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	Member	Invitation
Number of meetings held	4	
Number of meetings attended (actual/possible):		
Annell Bay	4/4	
Carol Chesney (Committee Chair)	4/4	
Bruce Ferguson		4/4
John (Jay) Glick		4/4
Richard Hunting		4/4
Jim Johnson		4/4
Keith Lough	4/4	

Composition and Frequency of Meetings

The Committee currently comprises three independent non-executive Directors and is chaired by Carol Chesney. Mrs Chesney is a qualified Chartered Accountant and is considered to have recent and relevant financial experience. Mr Lough and Ms Bay (Chair of the Remuneration Committee) have experience of the global energy industry, with particular expertise in the UK and US oil and gas markets. Further details of the Committee’s experience can be found in the biographical summaries set out on pages 96 and 97.

During the year, there were no changes to the composition of the Committee. The Committee meets four times a year and operates under written terms of reference approved by the Board, which are published on the Company’s website at www.huntingplc.com. In 2021, the Committee met four times in March, April, August and December, and the attendance record of Committee members and Board invitees during the year is noted in the table on the left. All Directors and internal and external auditors are normally invited to attend meetings.

Responsibilities

The principal responsibilities of the Audit Committee are to:

- monitor and review reports from the executive Directors, including the Group’s financial statements and Stock Exchange announcements;
- provide the Board with a recommendation regarding the Half Year and Annual Report and Accounts, including whether they are fair, balanced and understandable;
- review the Company’s and Group’s Going Concern and Viability Statements;
- monitor, review and assess the Group’s systems of risk management and internal control;
- review reports from the Group’s external and internal auditors, including details of the audit programmes and scope;
- consider and recommend to the Board the appointment or reappointment of the external auditor as applicable;
- agree the scope and fees of the external audit;
- monitor and approve engagement of the external auditor for the provision of non-audit services to the Group;
- review the external auditor’s independence and effectiveness of the audit process; and
- monitor corporate governance and accounting developments.

During the year, the Board agreed to establish an Ethics and Sustainability Committee to increase the review of monitoring of key ethics, environmental, climate, social and governance matters. The review work in respect of bribery and corruption, modern slavery, sanctions and whistleblowing was transferred to this new Committee, which held its maiden meeting in December 2021.

Review of the 2021 Financial Statements

The Committee reviews final drafts of the Group’s Report and Accounts for both the half and full year. As part of this process, the performance of the Group’s major segments is considered, with key judgements, estimates and accounting policies being approved by the Committee ahead of a recommendation to the Board. In addition to briefings and supporting reports from the central finance team on significant issues, the Committee engages in discussion with Deloitte, the Group’s external auditor.

Significant matters reviewed by the Committee in connection with the 2021 Annual Report and Accounts were as follows:

Convertible Financing to Well Data Labs

In February 2021, the Group announced the provision of \$2.5m convertible financing to Well Data Labs, a software development company focused on delivering real time drilling data to operators undertaking well completion operations. The Committee reviewed the accounting treatment of this investment, in addition to monitoring the carrying value of this investment at the half and full year.

Investment in Cumberland Additive

In August 2021, Hunting completed a \$5.1m investment in Cumberland Additive, a business that specialises in additive manufacturing and 3D printing of key products from the energy, aviation and medical industries. The Committee reviewed the accounting treatment of this investment, in addition to monitoring the carrying value of this investment.

Work Undertaken by the Committee During 2021

The Committee discussed, reviewed and made a number of decisions on key areas throughout 2021, which are set out below:

	Mar	Apr	Aug	Dec
Financial Report				
Annual Report and Full Year Results announcement	•			
Going Concern basis	•		•	
Viability Statement	•			
Interim Report and Interim Results announcement			•	
Review accounting policies				•
Internal control and risk management				
Risk management and internal control report	•		•	•
Key risks and mitigating controls	•			
Effectiveness of internal controls and internal audit function				•
Internal audit report	•		•	•
Internal audit programme and resourcing	•		•	•
Procedures for preventing bribery and corruption		•		
Procedures for complying with the Modern Slavery Act		•		
Sanctions compliance		•		
Whistleblowing summary reports		•		
External auditor				
Auditor's objectives, independence and appointment	•			
Full Year and Half Year report to the Audit Committee	•		•	
Final Management letter on internal controls		•		
Auditor's performance and effectiveness		•		
Proposed year-end audit plan including scope, fees and engagement letter			•	•
Risk of auditor leaving the market				•
Other business				
Whistleblowing and Bribery Policy Review		•		
Committee effectiveness and terms of reference				•

Restructuring of European OCTG businesses

In December 2021, the Group announced the completion of a restructuring of its European OCTG businesses, which included the purchase of the 40% interest in Hunting Energy Services (UK) Limited from entities owned by Marubeni-Itochu ("MI") for \$3.8m. As part of this transaction, the Group sold \$31.5m of inventory to MI, leading to a reduction in total inventory held, resulting in a net cash inflow of \$27.7m to the Group. The Committee reviewed the impact on the Group's consolidated balance sheet and the accounting treatment and confirmed it was happy with the presentation in the Group's 2021 consolidated financial statements.

Inventory Valuation and Provisioning Procedures

Given the protracted downturn in the Group's core trading markets, inventory valuation and provisioning procedures have been an area of scrutiny by the Committee and the external auditor. In 2021, the central finance function implemented detailed procedures and models for all business units to adopt, which included the evaluation of (i) stock obsolescence; (ii) slow moving stock; and (iii) product price movements within the industry. Further, historic pricing and forward looking pricing were adopted to generate appropriate provisions for all inventory held. At its December 2021 meeting, the Committee was briefed by the North America financial controller, the Finance Director and Deloitte on the progress of the roll out of these new procedures. As part of the year-end procedures, \$26.6m of net provision increases and impairments to inventory were agreed, given the trading activity of certain product groups. These charges are included as "middle column" exceptional items recorded in the Group's consolidated income statement.

Impairment Reviews

As noted in the letter from the Chair of the Committee, the Group's trading results in 2021 continued to be adversely impacted by the COVID-19 pandemic, in particular the slower-than-anticipated return to economic growth of many developed economies, which in turn impacted the drilling activity and equipment purchasing of our clients. As a consequence of this subdued trading environment, a review of indicators of impairment were carried out at both the half and full year, with respect to the Group's current and non-current assets.

Independent market projections providing an indication of drilling investment and activity levels over the medium term are published by Spears & Associates, which form a reference for the Group's forecasts. These projections support the impairment modelling completed by management. Management can make adjustments to these market projections to take into account its expectations for specific product lines or other geographic considerations relevant to Hunting's operational footprint. Following a review of the indicators to impairment, net inventory provisions of \$26.6m were recorded in H2 and are detailed in the Group Review on page 25. Management also considered whether any reversal of impairment was appropriate and have concluded that no reversal is required other than for certain inventories. It is noted that at 31 December 2020, \$79.8m of the impairment was in respect of goodwill, which cannot be reversed and that \$24.6m was for customer relationships recognised on the acquisition of Titan that would have been fully amortised by the end of August 2021.

Property, Plant and Equipment ("PPE")

The year-end balance sheet includes \$274.4m (2020 – \$307.1m) for PPE. This represents approximately 31% of the Group's net assets (2020 – 31%). The movement in PPE reflects \$6.5m of additions, offset by depreciation of \$28.9m, impairment of \$8.6m and other items totalling \$1.7m. The impairment charge of \$8.6m has been made against the property at Fordoun and relates to the reorganisation of the UK OCTG business and the consequential change of usage and expected cash flows for the property used by the business. The Committee reviewed the PPE impairment tests and, following discussion, was satisfied that the assumptions and the disclosures in the year-end accounts were appropriate.

Inventories

At the year-end, the Group held \$204.4m (2020 – \$288.4m) of inventory. This represents approximately 23% of the Group's net assets (2020 – 30%). Inventory levels have continued to trend downwards during the year, reflecting management's drive to eliminate excess stock, given the ongoing subdued trading of most of the Group's businesses. At the 2021 half year, a \$0.8m reversal to impairment was recorded. As noted above, more detailed analysis of inventory was completed, given the slower return to growth in the year leading to \$26.6m of additional net impairment charges being recorded.

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Goodwill

The year-end balance sheet includes \$164.1m (2020 – \$164.2m) of goodwill. This represents approximately 19% of the Group's net assets (2020 – 17%). Given the ongoing subdued trading of a number of the Group's businesses, the carrying values for goodwill for each relevant cash generating unit were tested for impairment, resulting in no charges being recorded. The Committee noted that the Hunting Titan operating segment had traded ahead of management's expectations during 2021, as the US onshore drilling market showed steady signs of recovery throughout the year. The Committee considered and challenged the discount rates and the factors used in the review process. After discussion, it was satisfied that the carrying values recorded and the disclosures in the year-end accounts were appropriate.

Other Intangible Assets

The year-end balance sheet includes other intangible assets of \$36.2m (2020 – \$42.9m). This represents approximately 4% of the Group's net assets (2020 – 4%). The amortisation charge recorded in the consolidated income statement was \$9.3m (2020 – \$20.8m), of which \$6.7m (2020 – \$17.3m) arose on acquired intangible assets. The amortisation charge for the year is significantly lower following the impairment of customer relationships and unpatented technology in 2020. The Committee considered and confirmed the appropriateness of the assumptions and factors used in the review process and were comfortable with the carrying values, as recorded.

Right-of-use Assets

The year-end balance sheet includes right-of-use assets of \$24.7m (2020 – \$29.8m). This represents approximately 3% of the Group's net assets (2020 – 3%). The Committee reviewed the movement in the carrying values of these items and confirmed the appropriateness of the assumptions and factors used in the review process and were comfortable with the items, as recorded.

Pre-Tax Amortisation and Exceptional Items Charged to the Consolidated Income Statement

The Committee considered the accounting policy definition of exceptional items and the items included within the financial statements to ensure consistency of treatment and adherence to policy. The Group has recorded \$44.9m of "middle column" items in the year (2020 – \$203.6m) as follows:

	2021 \$m	2020 \$m
Impairments	34.5	177.9
Amortisation of acquired intangible assets	6.7	17.3
Amortisation of acquired intangible assets – associates	0.3	–
Restructuring charges	2.0	10.3
Acquisition costs	–	1.4
Reversal of contingent consideration	–	(2.5)
Settlement of warranty claim	1.7	–
Loss on disposal of business	0.9	–
Profit on surrender of lease	(1.0)	–
Profit on disposal of Canadian assets	(0.2)	(0.8)
Total charges for amortisation and exceptional items	44.9	203.6

Taxation

In view of the international spread of operations, the Committee monitors tax risk, tax audits and provisions held for taxation. The Finance Director briefed the Committee on developments throughout the year.

Going Concern Basis and Viability Statement

Given the ongoing trading losses recorded at the half and full year, the Committee considered the Going Concern assumption to be disclosed within the 2021 Half Year and Annual Reports.

Detailed modelling of the Group's trading expectations were completed, including the review of a range of trading scenarios. Key to the Group's Going Concern assumption is its ability to retain a positive total cash and bank position and minimise trading losses until wider market conditions improve.

The Committee monitored these assumptions and the disclosures around Going Concern at the half and full year, as well as those around the Group's Viability Statement for the full year.

Further, the Committee noted the Group's new \$150m Asset Based Lending facility which was concluded and agreed in February 2022. The facility will provide significant liquidity to Hunting's businesses, with the facility secured against the Group's North American trade receivable balances, freehold property and inventory asset classes.

The Committee concluded that, given the flexibility of the Group's business model, coupled with the new lending facility, good support for Hunting's longer-term viability exists. Further, the assessment is supported by the year-end total cash and bank position of \$114.2m (2020 – \$101.7m).

These factors supported the Committee's assessment of the Going Concern Statement and the Viability Statement, as detailed on pages 92 and 93. The statements considered by the Committee were supported by reviews of the regular forecast updates provided by management and the bank covenant compliance reports.

On 28 February 2022, the Audit Committee approved the Viability Statement, detailed on page 92 of the Strategic Report.

Fair, Balanced and Understandable Assessment

The Committee has reviewed the financial statements, together with the narrative contained within the Strategic Report set out on pages 22 to 93, and believes that the 2021 Annual Report and Accounts, taken as a whole, is fair, balanced and understandable.

In arriving at this conclusion, the Committee undertook the following:

- review and dialogue in respect of the monthly management accounts and supporting narrative circulated to the Board;
- review of early drafts of the Annual Report and Accounts, providing relevant feedback to the executive Directors;
- regular review and discussion of the financial results during the year, including briefings by Group finance and operational management; and
- receipt and review of reports from the external and internal auditors.

The Committee advised the Board of its conclusion that the 2021 Annual Report and Accounts, taken as a whole, was fair, balanced and understandable at a Meeting of Directors on 1 March 2022.

Internal Audit

The Committee receives reports from the Internal Audit function. The Chair of the Committee also has regular dialogue with the function throughout the year. During the year, the activities of the function continued to be curtailed by the COVID-19 pandemic. However, activities did resume in H2 2021.

The Group has continued to implement a new ERP system within a number of businesses. To support this initiative, the Head of Internal Audit provided consulting services to the Chief IT Officer in respect of best practice control procedures and segregation of duties.

The Committee reviews the internal audit process and effectiveness as part of the Group's internal control and risk assessment programme. An annual programme of internal audit assignments is reviewed and approved by the Committee.

The Committee met with the Head of Internal Audit, without the presence of the executive Directors, on three occasions during the year. The effectiveness of the Internal Audit function was also considered by the Committee at its February/March meeting, which concluded that the function remained effective.

External Audit

Deloitte LLP was appointed by the Group's shareholders as external auditor in 2019 and therefore no tenders have been undertaken in the year due to their current tenure. This position also applies to the engagement partner attached to the Group's account. The external auditor presented reports at the March, April, August and December meetings of the Audit Committee during 2021. Further, the Chair of the Committee has also had regular dialogue with the audit partner throughout the year.

On 28 February 2022, a full-year report by Deloitte was considered ahead of publication of the Group's 2021 Annual Report and Accounts. In April 2021, Deloitte presented its Management Controls Report, which highlighted control improvements that could be made by the Group.

The Committee normally meets with the external auditor, without executive Directors present, at the end of each formal meeting.

During the year, the Company complied with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Process and Audit Committee Responsibilities) Order 2014.

Audit Scope

The Audit Committee considered the audit scope and materiality threshold. The audit scope addressed Group-wide risks and local statutory reporting, enhanced by desk-top reviews for smaller, low risk entities. Approximately 82% of the Group's reported revenue and 86% of the Group's net assets were audited, covering 22 reporting units, including a number of investment holding companies, across seven countries.

Materiality

The Committee discussed materiality with the auditor regarding both accounting errors to be brought to the Audit Committee's attention and amounts to be adjusted so that the financial statements give a true and fair view. Overall, audit materiality was set at \$3.5m (2020 – \$3.5m). This equates to approximately 0.4% of the Group's net assets for 2021. Furthermore, the auditor agreed to draw to the Audit Committee's attention all identified, uncorrected misstatements greater than \$175,000 and any misstatements below that threshold considered to be qualitatively material.

Audit Effectiveness and Independence

The external auditor's full-year report includes a statement on their independence, their ability to remain objective and their ability to undertake an effective audit. The Committee considers and assesses this independence statement on behalf of the Board, taking into account the level of fees paid, particularly for non-audit services. The effectiveness of the audit process is considered throughout the year, with a formal review undertaken at the April meeting of the Committee. The assessment considers the various matters including:

- the auditor's understanding of the Group's business and industry sector;
- the planning and execution of the audit plan approved by the Committee;
- the communication between the Group and audit engagement team;
- the auditor's response to questions from the Committee, including during private meetings without management present;
- the independence, objectivity and scepticism of the auditors;
- a report from the Finance Director and the Group Financial Controller; and
- finalisation of the audit work ahead of completion and announcement of the Annual Report and Accounts.

In addition, the Committee reviewed and took account of the reports from the Financial Reporting Council on Deloitte LLP, and reviewed a Transparency Report prepared by Deloitte LLP. After considering these matters, the Committee was satisfied with the effectiveness of the year-end audit process.

Non-Audit Services

The Committee closely monitors fees paid to the auditor in respect of non-audit services. With the exception of audit-related assurance services, which totalled \$0.2m (2020 – \$0.1m), there were no non-audit services fees paid during the year (2020 – \$nil).

The scope and extent of non-audit work undertaken by the external auditor is monitored by, and requires prior approval from, the Committee to ensure that the provision of such services does not impair their independence or objectivity.

Auditor Reappointment

Following discussion in February 2022, the Committee approved the recommendation to propose the reappointment of Deloitte LLP at the Company's 2022 Annual General Meeting.

ESEF Reporting

The Group is required to produce its annual report in XHTML format, an electronic format known as a structured report, to comply with the European Single Electronic Format ("ESEF") reporting requirements. Digital tags need to be applied to the Group's consolidated financial statements and the structured report needs to be submitted to the FCA's National Storage Mechanism. Hunting's central finance function has overseen the implementation of the ESEF requirements during the year. As part of the preparations for ESEF reporting, the Group's 2020 Annual Report and Accounts were tagged ahead of publication of the 2021 Annual Report and Accounts, which will be the first annual report to include the ESEF reporting format. A qualified IT provider has been involved in the preparation of the structured report and Deloitte has completed a number of assurance procedures on the structured report.

Review of Disclosures by the Financial Reporting Council

In November 2021, the Group received a letter from the Financial Reporting Council ("FRC"), which indicated that Hunting PLC's 2020 Annual Report had been reviewed as part of a thematic review of IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. The Committee was pleased to note that no issues were highlighted for improvement.

Internal Controls

The Group has an established risk management framework and internal control environment, which was in operation throughout the year. The Committee monitors these arrangements on behalf of the Board and these are detailed in the Risk Management section of the Strategic Report on pages 82 to 85.

2021 was the second year of abnormally low levels of trading given the economic impact of the COVID pandemic. This has resulted in the slowing of turn rates and increased ageing of a number of inventory lines. For 2021, management made enhancements to its provision estimation process to better allow for these conditions and more accurately reflect the impact on slow-moving items. The Committee has satisfied itself that the position taken at the year-end is appropriate. In particular, the Committee reviewed in detail management's analysis of the inventory provisioning methodology and challenged management on the approach taken. The Committee also discussed the approach at length with the Group's external auditor. The Committee also noted that the identification of additional inventory write-downs as part of the year-end process, while these changes were implemented, revealed weaknesses in underlying review procedures carried out by certain businesses in the North America segment. These weaknesses were remediated by segment and Group level management. While the Committee is satisfied that overall controls were effective, there will be a focus in 2022 on ensuring lower level controls are improved.

Review of Committee Effectiveness

During the year, the Committee reviewed its effectiveness and the Committee Chairman reported these findings to the Board. No issues were identified in this review process.

On behalf of the Board



Carol Chesney
Chair of the Audit Committee

3 March 2022