OMV Petrom Q3 2019 Conference Call – Q&A Transcript

OMV Petrom published its results for Q3 and January – September 2019 on October 30, 2019. The investor and analyst conference call was broadcast as a live audio-webcast at 3:00 pm local time. Below is the transcript of the question and answer session, by topic, edited for readability.

Group

1. Proposed legislative changes / Neptun Deep / Group CAPEX

Question from Tamas Pletser (Erste Bank): On the regulatory environment mentioned during the presentation: What is the realistic assumption as to when these new laws can be implemented in the Romanian regulatory framework? And when do you expect you can make a decision on your Neptun Deep project, in light of this new environment, in light of these new regulations?

Answer from Christina Verchere (CEO): With regard to the proposal from the government, what we see as the next step is actually to continue the consultation with the industry. Then it will need to be passed into legislation through the government process that will be put into place.

Concerning the content of what we have seen, we see that it addresses three of the key topics around stability, fiscal terms and liberalization of the gas market. This is a draft, so now, I think the most important thing is to see, actually, the consultation with the industry finished and then have it go through the legislative process, to see what comes out the other side of that. Probably a couple of comments with regard to the political situation and having a cabinet in place: because key to seeing this passed after the consultation is finished, is a cabinet to be able to do that. So, those of you who follow Romanian politics carefully may realize that we are expecting and understand that a cabinet will be voted on in Parliament, we believe, on Monday, so that will be a key next step to see. The other thing I would also say is that, just based on conversations and on things that we have read and continue to see, we see broad political support for the development of the Black Sea for Romania. So, maybe those would be the two aspects with regard to the next key steps that we would see.

At this point in time, I will probably say, as I have said for the last few calls, that we would not yet be able to put a timing as to when an investment decision will be made. But we do really see the fact that the legislation and draft legislation has been put back onto the table as a really, really important move forward for such an important topic for Romania.

I think the one thing I would also highlight with regards to anything about first gas, with a project of this size and complexity, we would estimate that once we are able to make an investment decision, it will be about four years to first gas that we would see. But overall, it is a first step, since our last call, of moving forward on the legislative side for the Offshore Law, with the key components that are needed to progress what is such an important project, obviously, for the company and also for the country.

Question from Tamas Pletser: I am not a very big expert, honestly, in the Romanian politics but do I see it correctly that somehow the events, or the whole process, has speeded up recently? Do you agree with that?

Answer from Christina Verchere: Sorry, just to clarify, when you say the process, do you mean the process on the legislation?

Question from Tamas Pletser: Yes, the process to solve this situation somehow, because it seemed to me that the politicians somehow realized that the current situation is not ideal for this project. So, without changing the legislation and the regulatory environment, there will be no offshore gas for Romania. Somehow, it seemed to me that this kind of process - to change the legislation, to have a proper framework in place - is now speeding up. Am I correct with this, or what is your opinion here?

Answer from Christina Verchere: Yes. I think it would be fair to say. If you recall, at our year-end earnings call, which was in February of this year, we said that the right legislation was not in place at that point and we have been in dialogue with the authorities over the course of the first half of the year. And yes, we would confirm that we believe we have seen progress because we have actually seen legislation, draft legislation, coming up. We have had lots of conversations but in the end, you need to see pen put to paper and that is what we believe we have seen.

Question from Irina Railean (Banca Transilvania): Regarding that NAMR order concerning the reference price for royalty calculation: does that apply to both offshore and onshore gas, or how exactly?

Answer from Alina Popa: Yes, it applies to both onshore and offshore. And what the order says is that for the sales on regulated markets, which are done at the price of RON 68/MWh, we take as royalty reference price RON 68 and not the CEGH price, as before. I will also mention that royalties are always calculated at the higher between the reference price and realized price.

Answer from Christina Verchere: If I could just build on that, one of the amendments in the legislative changes being proposed as regards the offshore is actually to get royalties back to being around the realized price, rather than the reference price. So, this was a first step forward. If you have a RON 68 cap – and CEGH in the past has generally been higher than RON 68 - you really want to be charged the right royalty for the price you are paying. But actually what we are also seeing is in the next step, a potential draft legislation continuing to close what we consider a gap in legislation about how the fiscal should be set on royalties. So, one more step to go.

Question from Tamas Pletser: I listened to the OMV conference call today and Mr. Seele mentioned that if there is a right fiscal and legislative term in place in Romania, then Petrom would increase the CAPEX and you are able to relatively reduce the decline rate of your production, mainly on the gas side. So, instead of 5% per annum, you can make around 3% per annum decline. My question is, would you confirm this information, and what kind of additional CAPEX do you need to slow down the decline rate of your current production? I see you have today around RON 4 billion CAPEX guidance for 2019. What additional CAPEX can we expect?

Christina Verchere: So, may I just clarify a few points there? For this year, we have stated that we will see a decline rate of around 5%. And as we talked about excluding divestments, we are on track to deliver that. We have also stated that our overall CAPEX guidance from 2017 to 2021 was about EUR 5 billion. We have spent about EUR 1.6 billion of that, so there is EUR 3.4 billion remaining and we remain on track to spend that money.

If I had one other clarifying point, it would also be just to emphasize that all the legislative changes that we are talking about with regard to the fiscal environment are about the offshore. With regard to the onshore, we have not seen changes in that yet, and the things that help us on the onshore side are really about a liberalized gas market. So, there are fiscal changes with regards to the offshore. About 20% of our current production is from the offshore, so it does have some implications with regard to any investment opportunities we would choose to make there. But for now we remain within our CAPEX guidance of EUR 3.4 billion over the next three years.

2. IFRS 16 impact

Question from Oleg Galbur (Raiffeisen Centrobank): On the IFRS 16 impact, could you tell us what the quarterly impact was in 2019 on earnings and which segments have benefited from the new financial standards?

Answer from Alina Popa: We guided that IFRS 16, basically, does not trigger an impact on our net profit line, so it is just a presentation and a change from rent to depreciation. When it comes to how much is that impact, it is approximately RON 15 million per quarter, presentation impact: increase in depreciation and decrease of rent expense primarily, a little bit of interest as well.

Downstream Gas

1. Gas market

Question from Oleg Galbur: Could you please help us understand what was driving the 37% year-over-year increase of Petrom sales volume, while the overall consumption in Romania actually was down 3% over the same period? I understand that to a certain extent, the growth resulted from more gas injected into storage.

But still my guess is that the 37% year-over-year increase does not represent the true picture of the Romanian gas market and I hope you can help us better understand its development.

Answer from Alina Popa (CFO): As you know, at the beginning of this year, we started to have regulated sales coming from the change in regulations here, so Petrom was allocated a portion of sales on the regulated market. On the other hand, Petrom tried to keep its customer portfolio. Now, we had a customer portfolio for the year, so we tried to maintain our customer portfolio and therefore we purchased gas from the market, both import and from the domestic market, in order to maintain our customer portfolio. Therefore, our gas sales volume growth is definitely much higher than that of the demand which, indeed, decreased by 3%.

Question from Oleg Galbur: Let's ignore the fact that you are obliged to sell a certain volume on the regulated market, etc. But just looking at the whole market as one pie and the pie is getting, even, a little bit smaller in comparison to the last year. And if one player sells 37% more gas on the same market, it means either that someone else actually is selling less gas or that there is a double counting. Then this 30%, as I said, is not a true representation of the gas market. This is what I am trying to understand.

Answer from Alina Popa: Okay, just a bit of guidance. We have this central market obligation as well, so we had a lot of focus in order to achieve our central market obligation targets of 50%. So, what we did in order to be able to achieve that, we had to trade a lot, to buy and sell on the market in order to comply with this regulation.

Question from Oleg Galbur: So, in the end, this 30% includes a double counting of this, or even –trading of the same volumes?

Answer from Alina Popa: Yes.

Question from Tamas Pletser: On the gas market in Romania, you showed in the presentation this large divergence between the Western European or the Central European prices and the Romanian prices of the gas. Do you expect this price difference to converge in the future? There was news recently that from the Western direction you can now import much more gas. I assume you are doing that, so what is the reason of this relatively large difference? Please shed some light on this.

Answer from Alina Popa: Continuing the question on gas markets and the difference between the gas price in Romania and CEGH, I would mention that Romanian gas prices on the free market are influenced significantly by imports. On the big picture, what we see on the Romanian market is the domestic production going down, by 8% approximately, if we look at our numbers. We see storage going up by approximately 30%, storage being higher at the end of Q3 this year versus last year, and we estimate that at the end of the year we will also have a storage level higher than last year. The rest is being covered by imports. Imports have two main sources, Russian gas, which is oil-linked, and also some imports which are coming from Hungary, where the tariffs are very high as the demand was very high. All in all, imports are influencing the Romanian gas prices on the basis of limited interconnection capacity.

You have asked also what about the future and how we see future gas prices in Romania. First of all, we need to see what is happening with the regulated market. We see clear indications that liberalization of the gas market might happen sooner than 2022, as provided by current legislation. There are two main legislative initiatives in the Parliament right now, one on the Energy Law, the other one on Ordinance 114. We also see a lot of pressure from the EU. So we see indication that the deregulation of the Romanian market will come faster.

Looking into the farther future, Romania is doing efforts in order to increase its interconnection, and this will trigger a narrower gap between our Romanian gas price and European gas prices.

Question from Tamas Pletser: And just one follow up here, you mentioned the bottleneck mainly is the capacity, the interconnection capacity from the direction of Hungary. What is the annual volume? I mean, what can go through to Romania from Hungary at the moment and what do you expect, can you provide any figures? How would this change in the future?

Answer from Alina Popa: It is 1.75 bcm per year technical capacity coming from Hungary. And it is not enough to look at the yearly capacity because it depends on which part of the year we are in. 1.75 bcm, this is currently the possibility of imports from Hungary.

Question from Irina Railean: You mentioned that import prices, if I correctly understood, are one of the main factors for increasing the gas prices on the local market. But as ANRE reports show, actually import gas prices are lower than what gas is traded on the Romanian market. So, what is your view, or what are the factors that influence the gas prices? What other factors do you see? Because imports are lower, production is lower; but to have higher prices you probably need a very high demand, but demand is also not very strong.

Answer from Alina Popa: The import prices we have seen from ANRE do not include tariffs, nor the transportation nor the capacity tariffs. So, due to the high demand – from Romania, these were very, very high, covering the difference to the realized prices on the Romanian market.

Question from Irina Railean: So, in your view, now, considering also tariffs and capacity booking, actually the real price is much higher than what is reported, right?

Answer from Alina Popa: Yes.

Downstream Oil

1. Refinery feedstock and IMO 2020 regulations impact

Question from Oleg Galbur: My question relates to refinery feedstock. According to my calculation, more than 25% of the crude processed at Petrobrazi refinery is non-equity crude. While you do not have much flexibility with your own production of crude, I wonder to which extent and how is Petrom trying to optimize its crude input in order to optimize, at the same time, the output of the refinery and take advantage of the IMO 2020 impact on the demand of middle distillates.

Answer from Alina Popa: Approximately 20% of our crude input in the refinery is coming from import. And as guidance going forward, we see 15–20% of import crude in our refinery. Of course, you know that we process entirely our crude in Petrobrazi.

With regard to IMO implications, indeed, we hope to be advantaged by the changes in IMO regulations, especially considering the fact that 80% of our crude input has less than 0.5% sulfur content. Looking at the yield of our refinery, 70% of the yield is represented by white products, so we do expect an increase in diesel crack spread, of which we will take advantage. And here, if needed, I could guide a bit on sensitivity: $10 per tonne in diesel crack spread will give us approximately $16 million impact in our refining margin.

2. Arpechim provision

Question from Tamas Pletser: On Arpechim, you mentioned that you had to make some provisions. Can you shed some light on why you needed to do this now? And can we expect any further provisions in the future for Arpechim refinery?

Answer from Alina Popa: Related to Arpechim, we have had, in the last year, in the financial statements a contingent liability with regards to Arpechim. Why it was a contingent liability? It was because we were not able to estimate reliably what is the level of provision for decontamination of the soil, so we disclosed this there as a contingent liability, without indicating an amount.

What happened this year, in discussion with authorities, or at the request of the authorities, is that we had environmental studies done, not for the entire Arpechim land but for samples of it, but they allowed us to make a reliable estimate for the full site. Based on this, we estimated a provision of approximately RON 220 million. The decontamination work is estimated to be finalized by 2030. Now, if we expect changes coming from here, we will assess this going forward. So, we could have slight changes, depending on how the analysis goes. But as of today, this is the best estimate and it was done very thoroughly, based on clear soil samples in a third party environmental study.

Disclaimer

This document does not, and is not intended to, constitute or form part of, and should not be construed as, constituting or forming part of, any actual offer to sell or issue, or any solicitation of any offer to purchase or subscribe for, any shares issued by the OMV Petrom S.A. (the Company) or any of its subsidiaries in any jurisdiction or any inducement to enter into investment activity; nor shall this document or any part of it, or the fact of it being made available, form the basis of, or be relied on in any way whatsoever. No part of this document, nor the fact of its distribution, shall form part of or be relied on in connection with any contract or investment decision relating thereto; nor does it constitute a recommendation regarding the securities issued by the Company. The information and opinions contained in this document and any other information discussed in this document are provided as at the date of this document and are therefore of a preliminary nature, have not been independently verified and may be subject to updating, revision, amendment or change without notice. Where this document quotes any information or statistics from any external source, it should not be interpreted that the Company has adopted or endorsed such information or statistics as being accurate.

No reliance may be placed for any purpose whatsoever on the information contained in this document, or any other material discussed verbally. No representation or warranty, express or implied, is given as to the accuracy, fairness or currentness of the information or the opinions contained in this document or on its completeness and no liability is accepted for any such information, for any loss howsoever arising, directly or indirectly, from any use of this document or any of its content or otherwise arising in connection therewith.

This document may contain forward-looking statements. These statements reflect the Company's current knowledge and its expectations and projections about future events and may be identified by the context of such statements or words such as "anticipate," "believe", "estimate", "expect", "intend", "plan", "project", "target", "may", "will", "would", "could" or "should" or similar terminology. By their nature, forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond the Company's control that could cause the Company's actual results and performance to differ materially from any expected future results or performance expressed or implied by any forward-looking statements.

None of the future projections, expectations, estimates or prospects in this document should in particular be taken as forecasts or promises nor should they be taken as implying any indication, assurance or guarantee that the assumptions on which such future projections, expectations, estimates or prospects have been prepared or the information and statements contained herein are accurate or complete. As a result of these risks, uncertainties and assumptions, you should in particular not place reliance on these forward-looking statements as a prediction of actual results or otherwise. This document does not purport to contain all information that may be necessary in respect of the Company or its shares and in any event each person receiving this document needs to make an independent assessment.

The Company undertakes no obligation publicly to release the results of any revisions to any forward-looking statements in this document that may occur due to any change in its expectations or to reflect events or circumstances after the date of this presentation.

The answers contained by this document are proprietary to the Company and neither this document nor any part of it may be reproduced or redistributed by any other person.