

OMV Petrom Q2 2020 Conference Call – Q&A Transcript

OMV Petrom published its results for January – June and Q2 2020 on July 29, 2020. 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. Dividend policy

Question from Iuliana Ciopraga (Danske Bank): I wanted to know whether the fact that you have negative free cash flow after dividends, is that affecting, in any way, your progressive dividend policy or not?

Answer from Alina Popa (CFO): We do have a progressive dividend policy and this is not affected in any way. We continue to be committed to this dividend policy. And if there is any change, we will announce it. However, we do not intend to change anything.

2. Climate change

Question from Oleg Galbur (Raiffeisen): My question refers to your today's press release about your support of climate related initiatives. And I wonder if the management would consider investing in green energy projects such as wind, photovoltaics, or other, in order to reduce the carbon emission at the Group level.

Answer from Christina Verchere (CEO): I will take the question about the focus on climate change as part of the energy transition. I would just reiterate one point that I made—we do see a very strong role for gas in the energy transition in Romania, with the targets it has, of about 44% carbon reduction and 45% energy efficiency improvement. Based on the plans there, we see a clear shifting out of coal that will be replaced by gas. So, that's going to be our key role with regards to contributing to the climate change agenda you are going to hear in Romania. We see the role for gas within transportation as well, with regards to investing in green energy, which is probably more towards the renewables. I think the areas that we will possibly look at and focus on are those that help reduce our Scope 1 and our Scope 2, so our own energy demand. Then, we will continue to look at possible options in feasibility. But our focus, really, at the big strategic level, as a company, is on the role of gas, going forward.

Downstream Gas

3. Gas regulations, demand and prices

Question from Tamás Pletser (Erste Bank): Can you elaborate a little bit on the major changes in the Romanian gas market and especially about the new regulation? How are the prices and market demand changing? And what is your position on this market?

Answer from Franck Neel (EB member Downstream Gas): What I can tell you, first of all, is the good thing we see, in terms of the evolution of the markets and that is the gas liberalization. We have seen in the first half of the year the evolution of the regulation to enable the full liberalization of the gas markets from the 1st of July.

With this, there are also some different measures. With no more cap on the gas price, there is no more central market obligation, which, for us, was quite a constraint because we had to sell 50% of our total sales. So, whatever we sell, not only what we produce, on the markets and we find a buyer for that. The gas storage obligation will be also cancelled, which was before also regulated by the ANRE, the Romanian regulator. So, that is a good news – liberalization.

And the liquidity on the market has improved, since March this year, we have seen an increase of liquidity. The regulator has replaced the CMO with the gas release program. So, it is a program which is more attractive, I would say, for suppliers to create competition on the market, because the producers are selling different products. So, months ahead, quarter ahead, season ahead, and year ahead, which enable to create more liquidity on the specific product, which is something we were not against, as a producer. We think it is a good thing to make sure there is liquidity on the market.

And what we have seen since we started this in June is that in terms of volume, it is increasing, which is good news. And we see new traders coming on the markets. So, that creates also new demand on the market in Romania.

But what we are still complaining, I would say, to the regulator is the level of the volume that we have to sell, which is 40% of our production minus our internal consumption and the technological consumption, which is also something we push at the end because it is important that Brazi power plant volumes, which are quite significant, are deducted from this obligation. But they are still quite high.

In addition, the other problem was the starting price, which was for June, nearly at CEGH levels. So, the Austrian gas market price minus 5%, which has meant that we have seen a drop between the Austrian market and Romanian gas market. However, we still achieved for the first auction in June a premium versus the CEGH price at the end of the auction.

This is what I can tell you very briefly about the market. So, we are quite satisfied about the evolution of the regulation. Still we see that intervention, as the gas release program has changed the rules after one month or the predictability and the stability is still an issue.

Moreover, there was the introduction of a new tax in the Energy Law 123 by the Parliament, which is also an issue for us. While it is more for the suppliers than for the producers, but we see also this as a new constraint to create a liberalized market. Overall, I would say the trend is going in the right direction.

Question from Tamás Pletser: And where do you see the direction of the prices? Are they following the European direction? I mean, are they going down in this period? And do you see this kind of convergence to CEGH prices of the Romanian prices?

Answer from Franck Neel: We see some convergence because of the GRP (the Gas Release Program) starting price. However, Romania is still an importer of gas, at the end, because we need to import for the winter especially. So, we will still depend on imports, and the price will settle certainly around the cost of import – to import gas for sale. That is what we see in terms of establishment of the market price in Romania.

Question from Irina Railean (BT Capital Partners): Just a follow-up question regarding the gas release program. If you could provide us the volumes sold in June and July in this program.

And regarding the gas market it is a little bit strange, what it is happening right now. I mean, fuel and power demand are declining and gas has even increased in the second quarter. At the same time, prices are still at the low level. If you could develop a little bit on this equilibrium that has been developed between demand and supply at this point in Romania.

Answer from Franck Neel: So on the gas release program – the level in June, we saw what was requested by the regulator, which was 30%. In June, it was 30% of production on different products. The total was 1.2 TWh for the June auction. For July, it is not finished yet. So, we are still ongoing with some of the products. But it will be very similar. It is a bit more, but not that much.

And the question, in terms of the gas situation, with the COVID, what we have seen in the gas market – in fact, that the consumption in Q2 has been quite high, a bit higher than last year, driven by the household market, first. You know, we still supplied some households' suppliers on the market. And this has been quite high versus last year because of the weather.

It is true we have still a decrease in the SME segment due to the COVID crisis. So, this segment has suffered the most for Gas and Power. But in large industrial segment, we are very pleased with our portfolio, which is very diverse, in terms of sectors, and not too exposed to the sectors who have been really impacted by the COVID. So, these are retail and the automotive sectors.

So, we have not been very impacted compared to other suppliers. Or the resistance of our industrial portfolio was very good. Some of them have even increased their consumption in June due to lower gas price and that goes to sustain good margins also on this segment.

Question from Iuliana Ciopraga: You were successful to get a premium effect with the prices set by the regulator for the gas release program. Can you provide any sort of detail, how large was the premium and do you see that as sustainable? Can you give us any sort of guidance on that?

Answer from Franck Neel: Concerning your question about the premium in GRP: what we achieved in June – only June is closed so far, July, as I said, is still open – is a 15% premium.

Question from Iuliana Ciopraga: And the other thing: is this premium sustainable? What are your expectations for the second half?

Answer from Franck Neel: It would depend on the period. Because for example, now there is low demand for summer, but high demand for winter. So, it would depend on the split between the products. It is too early to say.

Question from Iuliana Ciopraga: And this premium, has it been for all the products for the incoming months, for the next year? Is it reflected on all products?

Answer from Franck Neel: It is a weighted average.

4. Sustainability of results

Question from Oleg Galbur: My question refers to the Downstream Gas business, which has positively surprised us. Could you help us understand if this result is sustainable for the coming quarters or, in other words, driven by one-off developments in the second quarter?

Answer from Franck Neel: I will continue on your question about the sustainability of the results. I would say, yes, because we started one year or two years ago the development of the trading and origination, to be able to compensate the decline of the upstream production.

Even in this year, we had a good year versus what was forecasted, as Peter has explained. We see this in the volume. And we are confident we can continue on this trend and with the positioning we have on the different capacity reservations at the borders of Romania.

Also, our business model has integration between Power and Gas, and you see that in the results. Last year, we had a better result in Gas because the gas price was higher. This year, we have better results in Power because the gas price is lower.

So, when we can manage this integration, we are benefiting from that and I think we will continue in the coming quarters to have very good results in Power. And that is something sustainable, as such, of course. We have to make sure there is no technical problem on the asset, because that is another risk of the business. However, we are very happy with this integration and the benefit of that.

And the Power trading we developed in Romania has been a success also, in terms of the balancing mechanism, which is a very important source of revenue for us because we see in the Romanian market, the power plant is very well-positioned, in terms of balancing the network on a daily basis.

We do not depend on the spark spreads. We really depend on the situation of the network. And when we see the high CO2 price, it has an impact on the coal. The dry season has an impact on the hydro. So, the gas power plants really benefit from that.

And we see if it is sustainable, we won't see any new capacity coming in the coming years, even the next five years in Romania. So, major capacity as ours will benefit to continue to be a very important asset for Romania.

Upstream

5. 2020 production guidance

Question from Oleg Galbur: I have a question on your production guidance for this year. You are guiding for a decline of below 5%, although in the first half, production declined only by 1.7%. And I understand that the decline of 5% would imply anything between 1% and 5%, but I still hope you can provide more details so that we do not make a wrong assumption because, otherwise, a 5% decline would imply as much as an 8% lower production in the second half of this year. And if you could talk a little bit about the decline separately for crude oil and natural gas.

Answer from Peter Zeilinger (EB member Upstream): Yes, we maintained the 5%. However, you are right and the second half would then be very much affected. De facto, we have planned shutdowns for major gas fields in the second half – usually, we do that in the low oil price timing and when the gas demand is lower. So now, in July, but also in August, we have the maintenance of our gas facilities one by one. So, that will put pressure on gas production.

And the second topic is that, the reduction in drilling activities, which has happened now since April. This will have an effect towards the end of the year. And do not forget what we also tried to close this year is one of the divestment activities. So, that is still planned for the end of this year.

So, we have a couple of impacts for the second half. This is true. If you ask me now, I mean, we said we at least have the guidance as it is, but I am very positive that we will have a good second half of the year. So, in the guidance, it always said there, excluding portfolio optimization. I think we can take this off, and say 5%, we remain at 5%.

In Oil and Gas, actually, you see that we had some new gas fields or some new exploration we have brought on stream last year. We even had a press release and are showing this in our presentation. And those new gas resources, at the beginning, they decline faster and stronger than the mature fields, than the mature oil production.

At the same time, we get very good results from our workovers that we bought in last year. And these workovers stretch into this year and into the end in the second quarter. So actually, we had a good contribution from workovers and from new wells last year. We have a stronger decline in Gas – naturally stronger decline in Gas because they are younger fields. The big Totea field, but also Totea South. And that is why we see, also for the second half, a stronger decline in Gas.

Going forward, a bit of caution because the effects of the lower drilling activities would have an effect into next year. We will keep that discussion for the end of the year call, when we then look at the next year.

6. Opex/boe

Question from Irina Răilean: Could provide any outlook on opex? Could we see further reductions in the next quarters? Because as far as I understand from the presentation, most of the planned reductions have been made in the first half of the year. I saw a RON 0.2 billion out of RON 0.6 billion. So, may we see further reductions in the opex?

Answer from Peter Zeilinger: our target was always to maintain our stated opex despite the decline in production result and to maintain the unit costs. And we have managed to keep our unit costs below \$11 per boe. That was one of the targets that we wanted to achieve, and this was the side effect that we had since the decline in production.

Now, the oil price has helped in that respect because some of the opex is for fields that we have with contractors – and they are oil-price-related – but also the FX effect, of course. So, I don't expect a further drop, because we are already doing a strict cost discipline and will maintain it. But as we go, that itself will stabilize the production costs per unit, despite the further production decline.

Question from Iuliana Ciopraga: I have a question about opex. Is the current level of opex sustainable going forward? Do you still think that you can reduce opex, going forward, or are you close to the bottom now?

Answer from Peter Zeilinger: Going forward, of course, we have to maintain our strict cost discipline. And of course, in the current crisis, this is very strong and everybody understands the need for it. And we have come up with additional ideas on how to make our facilities more efficient and more productive.

However, as I said, we have to balance also for unit costs. We have to balance the decline that we have in production. So therefore, with the rising oil price and going forward, we will also have to pay higher fees to our contractors that are –some of them are oil-price-related. So, we will try to maintain our unit costs as good as we can, where we are on right now, but I don't see too much room for a further reduction.

7. Capex

Question from Iuliana Ciopraga: one final question on my side regarding Capex for Georgia or for Bulgaria. When should we expect any Capex for these projects?

Answer from Peter Zeilinger: With respect to Georgia and Bulgaria, first of all, it is not closed yet. So, we are not the official titleholder in Georgia or in Bulgaria. And in Georgia, it is a bit further away because we have just been announced as the winner of a tender that enables us now to do negotiations with the government on that production sharing agreement, which we hope that we conclude positively by the end of the year.

Georgia is a frontier exploration place and we have bid for an offshore license. So, the next step, once we sign a production sharing agreement, will be, of course, to do more exploration. So, we would start studies and thereafter, seismic.

Therefore, serious Capex would be still at least two years – I mean, in our case in Georgia and more or less the same in Bulgaria. Bulgaria – we hope to close soon – and seismic acquisition has been done this year. So, the next step would be to analyze the seismic and see which one of the prospects in the block would be working, and then go for the internal approvals, and prepare for a drilling. And you know, a deep water drilling cannot be done overnight. So, it would then go into tendering phase and then end.

So also here, I do not expect that serious Capex will be spent in the next year but thereafter we will analyze based on prospects.

Downstream Oil

8. Marketing results

Question from Iuliana Ciopraga: What do you expect for marketing in the second half? Do you see an impact on volumes? Moreover, do you see this impact on volumes being compensated by higher margins?

Answer from Radu Căprău: I will take the question related to the demand. So, we have been seeing, indeed, a very, very difficult second quarter. But we have to say that at the end of the day, we saw a -25% in retail at the group level, as indicated by Christina. But it is better than our initial assumption, which was -45%.

What we see these days is a recovery in Romania, we see volumes recovering. However, we need to look as well at the other countries that we are managing. Let's start with Bulgaria, Serbia then Moldova. They have been significantly affected by the COVID cases in the international routes and international traffic. So, our assumption for the year is that we will be seeing a decrease year-over-year of the demand by less than 10% comparing with 2019.

About the question related to volumes compensated by margins, we had robust margins in the first half of the year, in a context of falling quotations. But now, we must worry. We see a certain pressure as quotations are moving up, putting pressure into the sales channels margins.

9. Discounts to Brent

Question from Iuliana Ciopraga: I noticed one thing on the price that you achieved for oil, that the discount that you have was significantly lower in the second quarter. I guess, the discount reflects, of course, a much lower oil price. But was there something else that impacted the discount? Is this decrease somewhat sustainable in the future or not really? Is it fully resetting the decrease in oil price?

Answer from Radu Caprau (EB member Downstream Oil): So, we have been seeing Urals extremely volatile in the second quarter. So, being traded at premium to Brent, that's a situation that we saw, these days, you are already seeing being flattened. And the expectation is that, for the rest of the year, will be still strong, but on a relative equal value with Brent.

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