

OMV Petrom Q3 2020 Conference Call – Q&A Transcript

OMV Petrom published its results for January – September and Q3 2020 on October 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. Offshore Law

Question from Tamas Pletser (Erste Bank): My question would be regarding the regulatory issues. I think Christina mentioned during the presentation that she expects, in December, a new Parliament to be elected and then the Offshore Law to be negotiated. Can you tell us a little bit more about the situation?

Answer from Christina Verchere (CEO): What we hear consistently from the authorities is a commitment to revise the Offshore Law, but also that it will happen after the elections. The parliamentary elections are due to happen in early December. I think what we would expect to see are changes to the Offshore Law being entered into Parliament when it opens in February 2021. Because, obviously, after elections, the Government will need to be formed, Cabinet put in place, etc. However, when Parliament opens, we would be looking to see changes being proposed for the Offshore Law. That may be the milestones, that you should be looking for and roughly the timeline based on what the authorities have said.

Question from Tamás Pletser: Do they accept or have they accepted already the framework of the Offshore Law? Do you know how this would look like or is it still under consideration and under negotiations, how the framework of this law would be?

Answer from Christina Verchere: No, they have not published a draft law for consultation. That will happen in the parliamentary process, it goes to the Industrial Services Commission. At that point in time, the associations and the sector is able to provide comments.

What we have been, as an industry and as an association, very clear on the key areas that we want to see changed, mainly sitting around the stability clauses, the fiscal terms, and just clarity around the right to free market. These are the key aspects that we are looking for. They are aware of what we like, but we have not seen a draft. I do not expect we would until it came into the Parliament.

However, that has never changed. I think the commitment to change, from what I can see, is based on our comments to say we needed a change and this is what we are looking at.

Just want to give the color – one thing we do share is the level of taxation in Romania for offshore gas and comparing it to the rest of Europe. It is about five times high as European royalties, supplemental tax and income tax. For elsewhere in the Black Sea, it is also very hard. From a competitive perspective, it is not competitive and many studies are able to demonstrate that.

Question from Tamás Pletser: I suppose you start to lobby again to lower these taxes, if they are so high.

Answer from Christina Verchere: Yes. We work a lot on the advocacy side of that through the Industry Association.

2. Capex

Inrina Răilean (BT Capital Partners): Under this lower commodity price environment, may we see further declines in the CAPEX in the following three years, in the mid-term?

Alina Popa (CFO): Unfortunately, we are not ready to disclose to you our CAPEX figures for next year. We are doing, as we speak, a lot of simulation analysis and so on. We will come back with a full disclosure at the beginning of next year. What we have done, we have, of course, adjusted the CAPEX for this year. You have seen a 30% reduction from our original budget ending up from RON 4.2 billion to RON 3 billion, excluding acquisitions. For the next year, we will come back to you at the beginning of next year.

Downstream Gas

3. Outlook for Power segment result in the context of changes in gas prices

Question from Oleg Galbur (Raiffeisen Centrobank): On the gas and power business, which has been delivering strong earnings over the second and third quarters. Could you please help us understand to which extent the sharp increase of the European gas prices could spoil the party and put the pressure on segment earnings?

Answer from Alina Popa: First to mention is that the main part of our great result of Downstream Gas business is coming from Power. We see this both in Q2 and in Q3 as well.

To explain this a little bit – and apologies for not being able to provide a detailed split between gas and power results – it is basically coming from the fact that we are running the power plant as an optimization unit. We always optimize what is the best between selling the gas and/or putting it into the power plant and selling the power.

This corroborates to the fact that we managed to have very good forward contracts concluded previously and most of them were last year, where we are able to capitalize and obtain very good results on the power segment, partly also coming from a high flexibility of the power plant and achieving good results from balancing market as well. As mentioned, in Q3 we were able to cover 10% of the Romanian power production.

With regards to the gas result, what we have seen is a pressure on the gas price. On one hand, what we see on the short term is an alignment of the Romanian gas prices with European prices, as interconnection capacities of Romania developed significantly in the recent period. On the day-ahead – on a short term, we see this gas prices coming closer together.

On a longer term, we see discrepancies. This is coming because of this Gas Release Program, which was introduced in June in Romania. This puts a lot of artificial pressure on the gas price, as it starts from a gas price of the previous transactions minus 5%. This is a challenge right now because this drives, of course, the price down.

Question from Oleg Galbur: You are saying that the results of the gas and power business were mainly driven by the existing forward contracts signed last year. You have most probably benefitted from recovering of power prices, at the same time, having a cheaper feedstock for your power plant, which means cheaper gas. I was asking now that the gas prices are going strongly up, would that mean that the contribution of the power business might decrease significantly, going forward? Would that be a fair assumption?

Answer from Alina Popa: It is. First to mention is that we do not see this strong recovery of the gas prices. What you see at the European level, we do not see in Romania, as Romania was never that low as Europeans gas hubs were. We do not have these effects.

Going forward, what is beneficial for us is the power stated integration. We will always have these two options and will try to optimize and choose the best between putting it into the Brazi plant or selling the gas. It depends also to what extent we will be able to conclude forward contracts, in the future. We are working hard on that side as well. Hard to say, from today's perspective.

Question from Jonathan Lamb (Wood & Company): Once again, a resilient performance. However, one thing that worries me is that in 2021, if the situation in the power market changes, you are going to struggle to reproduce this this level of downstream a bit. How do you see the power market in 2021?

Answer from Alina Popa: In 2021, indeed, we will see it a bit weaker than this year. We will expect the power result contributing less than in this year, which was exceptionally high. As I said, from our perspective, we rely a lot on the integration of our business, and on our possibility of capitalizing either by power or by the gas prices, if the gas prices will be higher than this year. Indeed, we expect a weakening of power. However, we hope to have a better gas situation when it comes to next year.

Answer from Christina Verchere: Maybe I would just add, what we have been able to see this year is this resilience of the value chain that we have. Where we can lose some value in certain parts, we can also gain in others. Part of that you can see in the power side. We have also seen at some point in the year, actually, when it went from

Upstream into Refining. Then, Refining dropped a lot. Then, we saw the benefits of the retail side of that. I think yes, you are right. We may not see the same in power, but I think we can also say there will be other opportunities. Again, depending – it is an unpredictable world right now, as you know very well. However, I think what we do see is actually the portfolio and the asset base does have some versatility to it. It may not be in power that we are able to do it, but what we are able to maybe do it in other aspects of the portfolio.

4. Demand for gas in the context of COVID crisis

Question from Tamás Pletser: First of all, can you tell us what the current situation is with the demand regarding gas and power?

Answer from Alina Popa: When it comes to gas, gas is broadly stable. This is driven by your gas-to-power users and the fertilizer industry, which benefitted also from lower gas prices that triggered the increase in demand.

When it comes to power, we also see lower demand, but also around single-digit, so less than 10% versus previous year. These are our estimations now, considering no significant lockdown until end of the year.

Irina Răilean: Regarding the gas market in Romania: I would like to hear your view regarding what may drive a recovery in the gas market prices in Romania in the next year or in the mid-term, generally?

Christina Verchere: Maybe just a few comments on sort of where we see the gas business further and gas market going overall. Given the context of the pandemic, the gas markets actually held up relatively strongly in Romania. Yes, we have had lower prices, but not as low as we have seen elsewhere in Europe, in that regard. I see demand has responded to that, particularly from the fertilizer industry.

However, if you just stand back from the bigger picture, with regards to gas, Romania, like many other EU countries, is working on the climate change and energy plan. Romania clearly has a plan to reduce its level of coal and replace that with gas and renewables. Obviously, this, fundamentally, is an underpinning of the strategic use of the Black Sea resource in the country, overall, and a strong desire to connect the nation more.

It is actually not very highly connected for the households in Romania. There are many people who actually are not connected. We mentioned an Order that had been passed. This will also increase some demand, in the medium term, overall.

The other aspect with the market, overall, is more interconnections continually built and connect Romania to the rest of EU. This will drive more liquidity into the overall market. For the long term, we believe that is a good thing. We want a fully liberalized gas market. That has the benefit, both as a producer but also marketer, and a supplier and trader. Overall, it is hopefully moving in the right direction.

Downstream Oil

5. Hedges

Question from Oleg Galbur: Regarding your hedges, are they on diesel? Could you tell us if you have any hedge positions for the next year for refining products or crude oil?

Answer from Alina Popa: We have concluded hedges at the end of last year for middle distillates – approximately 60% of our middle distillates. We also unwound these hedges during this year. What you should expect is to see approximately RON 60 million positive impact from these hedges in Q4. For 2021, we see approximately \$6.5 million positive effect from hedges every quarter.

Question from Oleg Galbur: It means that your hedging positions cover also the full year 2021?

Answer from Alina Popa: Partly, yes. However, the impact from these hedges are not significant as we already realized these positions. We already unwound the hedges.

Question from Raphaël Dubois (Société Générale): Did you have any crude hedges in Q3? That is something OMV Group mentioned this morning during the conference call. Did you also have some of those hedges?

Answer from Alina Popa: We have no crude oil hedges for Petrom. That is not the case.

6. Auchan

Question from Raphaël Dubois: Could you please tell us a bit more about the margin improvement we should expect as well as the speed of development?

Answer from Christina Verchere: We do believe our Petrom filling station business is a strong one and it is competitively being able to demonstrate that during this period.

This is, just as a recall, a pilot that we have run through the last couple of years. We have been able to see improvements in both the non-retail margin as well as also in throughput coming into our forecourt overall, which is what has given us the confidence with Auchan to expand this, obviously, to the full set of the Petrom filling stations and, at the same time, use it as an opportunity to modernize the Petrom filling stations across the country. It is a strong multi-year plan and following a model that is new here in Romania, though I recognize it is not new elsewhere within Europe.

We do expect to see an improvement in margin. We are knackered to this point in disclosing net improvement in margin, but we think the results will speak for themselves. Overall, we have continued to see strong performance from our Retail business. We were seeing it before COVID. We have definitely seen it during the COVID period, overall. Our plan is that we will have 20 stores done by the end of this year and 400 done within five years. You should start to see that margin performance improvement showing up in the financials very much by the end of next year.

7. Utilization rate and refining margins OMV Petrom vs. European averages

Question from Raphaël Dubois: The other question I have was about your Refining business. Your utilization rate is above the European average. Your realized refining margin is above zero, when most of your peers register negative margins currently. Based on your output, you apparently expect to continue recording a positive refining margin. Can you maybe tell us a bit more about this competitive advantage that you have, allowing you to work at higher rates than the others and still record positive margins?

Answer from Alina Popa: On the refining margins, what I would like to highlight is that the yield structure of our refinery has a significant component around gasoline and diesel. More than 70% is gasoline and diesel. We have a very small percentage of jet. We were able even to reduce it below 3%. This allows us also to run the refinery at quite high levels.

In addition, we were able to manage our stocks very well. What we have done to optimize our net working capital and operations was that we supplied our Downstream countries with products from the Petrom refinery instead of buying from third parties. We also managed to do some exports. All in all, we were able to run the refinery at quite high levels due to all these measures taken during the crisis.

8. Demand for fuels in the context of COVID crisis

Question from Tamás Pletser: First of all, can you tell us what the current situation is with the demand regarding fuels? I see that the number of COVID cases are surging across Europe as well as in Romania. How do you see the current situation with the demand? Can we expect, potentially, a decline in demand in the fourth quarter? If it is the case, how big can this be?

Answer from Alina Popa: Tamas, indeed, you are right. What we see in Romania is an increasing number of COVID cases in the last weeks, week after week. On the other hand, we do not see this being reflected in our filling

stations or on our product demand. This is also because authorities are making huge efforts in trying to address this medical crisis without a second lockdown and without affecting significantly the economy.

Of course, we need to see how this will evolve, going forward. However, based on the recent public statements, this is the big effort of authorities to try to keep this under control from the perspective of not being needed to really close the country again.

From our perspective, considering this, we see retail demand for the year being less than 10% lower than previous year. With regards to non-retail, we see also non-retail demand around 10% lower than previous year. Jet it is very bad, more than 50% lower than previous year.

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