# OMV Petrom Q2 2021 Conference Call – Q&A Transcript

OMV Petrom published its results for January – June 2021 on July 28, 2021. The investor and analyst conference call were broadcast as a live audio-webcast at 3:00 pm local time. Below is the transcript of the question and answer session edited for readability.

### Group

**1. Neptun Deep, Offshore Law, co-operation with Romgaz**

**Question from Tamas Pletser (Erste Bank):** Christina, can you tell me a little bit about OMV Petrom's position on the Neptun project? You mentioned in the presentation that you expect by end 2021 the new offshore law and you also mentioned that Petrom is ready to be the operator of this project if it goes on. My question is, would you be comfortable with the current setup, you and potentially Romgaz making this project? Or will you be more confident or more comfortable to take a third-party who may have more knowledge, more expertise with the offshore drilling and production?

**Answer from Christina Verchere (CEO):** With regards to Neptun, as you said, we do see and expect changes in the offshore law this year. And partly we think that it is obvious the continued alignment by the Romanian state, to see this natural resource developed, particularly in the context of its role in Romania's energy transition overall. And also, as you can see, obviously with Romgaz's interest to be in the project and given that is a predominantly state-owned company with regards to that.

We did announce that in the event that Romgaz enters into the joint venture, OMV Petrom would be the operator. And obviously, that is based on a high degree of confidence in being able to manage the operatorship.

I will make a couple of points on this and then I will hand over to Chris, because he can give a little bit more detail. The main point, obviously, we have been an operator in the Black Sea for 40 years, offshore. And so, we have a lot of experience, I would say, in how to do that work from a logistics perspective, helicopters, all these aspects of it. And obviously, the developments in drilling activity as well, combined with support from the main shareholder with regards to deepwater activities.

So maybe I hand over to Chris and he actually adds some further context behind that question.

**Answer from Christopher Veit (EB member responsible for Upstream):** We know that these are one of the most important developments of Neptun, for us and for Romania. And the operatorship is very essential for us to be taken. And so, as Christina said already, we are building on 40 years of experience here, but we also draw our capability actually out of the pool of OMV, where OMV has experienced in deep water and other offshore developments. That is actually how we would like to manage this project and deliver it on time and on budget.

**2. OMV Petrom strategy changes in the Fit for 55 context**

**Question from Irina Răilean (Banca Transilvania):** The question is more a long-term question, a strategic question. Considering the carbon neutral targets and since we have seen that many oil and gas major players have already announced a shift in their strategy, does Petrom envisage such a shift towards renewable or other sources of energy? Or how exactly will Petrom adapt to this climate policies requirement?

**Answer from Christina Verchere:** With regards to overall carbon targets, decarbonization strategy, etc., I think it is fair to say that any energy company, particularly in oil and gas, is very focused on the transformation and particularly, in the context of our markets, because we are in the EU, and this is the EU who is looking to lead the way and the Fit for 55. But also, we need to take into consideration Romania too, and what will be the solutions needed for Romania to be able to reach its Fit for 55 and beyond that.

So, in this context, you can see that gas is a focus for Romania because this clearly aligns with our existing strategy too with regards to Neptun Deep. And we see clear alignment with Romanian state with regards to that, and we see that contributing to the decarbonization of Romania, both with the replacement of the coal, but also with the balancing that is needed with the large amount of renewables that will come in also to replace coal.

In addition, when you look at Downstream Oil, we do see a significant fuel demand growth underpinned by pretty strong GDP that we expect. Obviously Romania is coming from a relatively low base. But the increase in infrastructure, the increase in the car fleet size, given the car fleet size in Romania is substantially below the EU average and overall economic improvement in prosperity, we do see fuel demand. Operationally, we have reduced our GHG intensity by 26% versus 2010, and that is almost ahead of our target. We plan to deliver 27% by 2025, so good progress on that.

We are looking at renewable opportunities and we are looking at biofuels for our products as well. In addition, but beyond 2030, we are starting to look at carbon capture and storage, carbon capture utilization as well as hydrogen. These are more in the research and pilot phase, so we really need to see how we can get them to the commerciality.

But with regards to the holistic nature and bringing it all towards you, because we are working on a strategy update right now internally, our goal is to bring that to capital markets in the fourth quarter this year. So, we will be able to turn that into discrete actions and items that we can talk to you about hopefully by the end of this year.

## Downstream Gas

### 3. Gas prices: Romania vs. Europe, impact on demand, sustainability; storage levels

**Question from Tamas Pletser**: regarding the natural gas market in Romania, how do you see the current market development; are the current gas prices acceptable for the Romanian consumers? And what is your experience with the current centralized gas market issues and your obligation over there?

**Answer from Franck Neel (EB member responsible for Downstream Gas)**: First of all, what we would say about the Romanian gas price is that, due to the increase of interconnection we have seen in the last years between Romania and the neighboring countries, we see now a good correlation between the West European market and Romania. But still, there is some spread between these markets. You mentioned the gas release program, so it is a program which started last year. It will finish at the end of the next year.

This other impact on the price is because the way it is built – and I do not want to go into the details of the construction of the gas release program because it is quite complex. But it creates a price which is lower than the Hungarian market, for example, which you see on the forward price.

On the spot market, as the markets are more correlated, we are quite close to the Hungarian market and I would say it really depends on the supply-demand situation on the day. But so, you have a strong correlation on spot, less correlation on the forward, but still the trends are similar due to supply-demand and interconnection.

**Question from Tamás Pletser**: Just a follow-up here, if I may. Can you realize those prices which are on the exchange? Because as I know the structure of this gas release program, we start at lower price than the previous market price. So, can you, on average, realize those prices which are on the gas exchange?

**Answer from Franck Neel**: So, the way the gas exchange is working, you have a starting price for the different products, and the starting price is based on the average of the last 60 days on the transactions of these products. So, you have a time lag, but not that big, 60 days, so it will depend on that. You tend to see a time lag on that, but the trend is upward on the GRP as well, if you look at the quotation at the moment. We are selling gas for next year at around €25 per megawatt-hour. So that is close, a bit below TTF, but not that far.

Now, we have only part of the volume we are selling, it is about 30% of the total volume on the gas release program. For the rest, on the end user, there is a time lag as well because we sold last year the gas on contracts that usually are from October to September. So, we sold last year, for this year until the end of September. At the time these contracts were contracted, the prices were quite lower than what you see today in the market. But this is, again, when we see the renewals of these contracts starting 1st October this year, depending on when they will be signed, they should be closer to the market, of course, because the pricing is based on the forward on the market.

**Question from Tamás Pletser**: And just one more follow-up over here, if I may. Due to these high current spot prices, do you see any destruction of the demand for natural gas among those customers who buy on the spot market? And how is the current storage level in Romania? Do you see any problems to fill up the storages for the winter period?

**Answer from Franck Neel**: Demand, again, it is too early to say because, as I say, most of the customers contracted last year. So, they are not seeing yet the price increase. I think we will see; if there is a demand destruction, I think we need to wait the winter to see if something happens, especially in the chemical sector. But at the moment, no, we do not see this. The GDP growth, as mentioned by Christina, is quite strong, so the economy, and we pass through the cost of commodity in the market at the moment.

But let us see. We will say it again, wintertime will be more relevant to see if there is an impact on demand. Concerning the storage level, yes, we are quite below last year, if you see the storage at the end of June, but that is also linked to the fact last year we were quite above previous years due to the Ukrainian-Russian crisis. I will say this year we should finish, by the end of the summer, below a normal storage year, mainly because summer prices are very high compared to winter prices, so the spread is not always there. But it is moving. So, we need to wait if there is some opportunity on the market as well.

For Petrom, so far, we have done well, so, as of June, we are quite in line with last year and we will see by the end of the summer where we finish. We try to capture winter-summer spread when there are opportunities in the market.

**Question from Irina Răilean**: I have a follow-up question on the gas prices. And I would like to ask, do you see them as sustainable for 2022? And in the long-term, gas prices above 100 lei per megawatt hour, is this sustainable in the long-term or is this just a temporary imbalance on the market and that is why we see such high prices? And also, if you can tell us if the prices or the level of prices on the centralized market are representative? Do they mirror what happens on the OTC as well? Because we do not see the OTC market and bilateral contracts, so that is why I am asking.

**Answer from Frank Neel:** Gas prices are sustainable for us. I think what we see at the moment is that gas prices in Romania are still below neighboring countries. So, in terms of competition, for industry, we still benefit versus other countries. Now, it will depend on the competition coming from outside of Europe. But at the moment, we see the strong demand on the market, plus 8% gas consumption in the first six months. It is true the weather had quite an impact.

Now, are we going to see some destruction of demand? I think it is too early to say. The wintertime will really tell us, and the next calendar year. Now we are talking about summer price well above €30 per megawatt-hour. Next calendar of year is around €25 per megawatt-hour. We see a bit of a decrease, but it will also depend of course on the winter, how the winter will behave, as we have low storage. But at the moment, we do not see destruction of demand.

**Question from Irina Răilean**: But it is a little bit strange what is happening on the Romanian gas market. We are also importers. We know that our gas production, gas levels does not fully cover the demand for the entire year. So we are importing some quantities of gas. At the same time, our prices are lower than in the neighboring countries. So, we are exporting gases, something quite strange because if we need to import gas, why are we exporting natural gas? Next cold season we just should be importing at higher prices.

**Answer from Franck Neel**: There is something which we highlighted already last year to the regulator with the gas release program, which creates, the way the price starts, when you have a market price going up, you have a time lag because we are looking at the average of the last 60 days. And this time lag and the fact that, not every customer has access to the gas release program. So, you do not have the full demand on the market coming to the gas release program. So, you have quite a large supply on the gas release program, not that much customers on the market, and the people benefitting from the price, which is below the Hungarian one, which is the closest market. And, of course, it creates some strange cross-border spreads. But you have to keep in mind that some of the main supplier who is buying this gas is also protecting prices for the household market. So, the price you see on the household today is well below the market price, because they are both from gas release program last year at quite good price and even at the beginning of this year. So, there is a time lag. Some of it is even more important for the domestic markets than for the B2B, which is why we are active because the B2B will depend on the import price. But it is complex because of that. Yes, you are right.

### 4. Transfer price between Upstream and Downstream Gas

**Question from Oleg Galbur (Raiffeisen Bank International):** the next question refers to Petrom's realized gas prices. And I know that you do not disclose them. But just to help us understand to which extent the company could benefit from the current environment of high gas prices, could you please talk a bit about, first of all, how is the transfer price of gas between Upstream segment and Downstream Gas segment set? Because I understand that it is linked to the market price. But based on my calculation at least, I see quite big differences from quarter to quarter in terms of premiums or discount between Petrom's realized price and centralized market prices. And I would like to understand the reason for this big swing from quarter to quarter.

And secondly, also help us understand how much flexibility with the gas pricing for your clients do you have for the second half of this year in order to, again, help us understand if you could take advantage of the current environment of high gas price. And so here, of course, I refer to the Downstream Gas segment where you have different terms, contracts, and, of course, as it was already mentioned, some of them were signed last year when the prices were significantly lower.

**Answer from Franck Neel**: It is nothing really rocket science; as the transfer price is based on the commission as those sales are driven for Upstream. I will not give you the details but there is nothing really unusual in that.

In terms of the realized gas price, as I mentioned, you have, first of all, the gas release program, which is a quite significant part of our sales. For this volume, you have 60 days delay due to the way the price for product is calculated. So, the trend is going up. But, of course, we have what we saw last year for this year; we have an impact. And what we expect now is that next year, we will have some benefit from the increase of the gas prices as we already started to sell now products for next year with quite high prices. So we will see, I think, some positive news coming from Q4 and Q1 and especially calendar next year due to the move of the price.

On the end user, and we have also customers directly connected to our Upstream activity, more distribution companies. Here, the price is different when it was fixed, but as I mentioned before, most of them were fixed last year. Most of them also will finish by the end of September. So we will see again, depending where the price is going of course, but as we see the trend is rather bullish, the price will be fixed based on the forward markets, which will be based on the market price we will see at the time of signature. Of course, we believe in competition bid from the customer side.

## Upstream

### 5. CAPEX and production decline guidance and correlations

**Question from Raphaël Dubois (Societe Generale):** My first question is on the CAPEX guidance that you give for 2022-2023. It goes up. It would be great if you could remind us the reason why you expect to spend more money in the next two years, if you can give us a bit more colour? And also, the split per division.

And my second question, which is in fact related, is on the production decline. Putting aside the eventual start-up of Neptun, should we expect your base production to continue to decline every year? Or could you at some stage try to revert the decline by spending more money in Upstream?

**Answer from Alina Popa (CFO):** I will start with the CAPEX. For 2021, we have an estimation of CAPEX of RON 2.9 billion. We kept our CAPEX quite at a prudent level as we see a lot of volatility going on.

Now, moving further to 2022-2023, our CAPEX guidance is around RON 3.8 billion – it will increase with approximately 30% to RON 3.8 billion for 2022-2023. This RON 3.8 billion will be split between Upstream, around RON 2.5 billion, which means approximately 25% increase versus 2021. We will go up with the number of wells to around 60 wells per year and also with our workover operations.

With regards to Downstream Oil, the guidance is around RON 1.2 billion and it goes to refinery but also to some retail investment. This is based on today's perspective around CAPEX we plan to spend.

**Answer from Christopher Veit**: Concerning the decline, we are actually fighting a natural decline in our mature fields of more than 10%. And what we have seen, of course, CAPEX is essential to spend on it. And drilling and workover is very sensitive to that. So that is why we also see higher decline this year because we spent less last year and also this year. So, in average, I would say, you should expect a further decline on it. There could be a positive impact coming from our EOR projects that we are doing but this is only for next year. So on average, I would say, we are aiming to stabilize it at about 5%.

Of course, all is depending on the business environment and the volatile oil price. But this is exactly what Alina was mentioning. We are ramping up a little bit next year on the CAPEX and increase also the drilling activity. That should actually stabilize it a little bit more than we did it in the last two years.

**Question from Raphaël Dubois**: Maybe just one follow-up on the last topic considering the better macro-environment, the better oil price, your strong balance sheet, the fact you do not need immediately to deploy that money until Neptun is FID ed. Would not be possible to spend already a bit more money into Upstream to further lower the decline rate? I understand you already fight to get a lower decline rate from 10% to 5-ish percent. But do you not have the resources to do more?

**Answer from Alina Popa**: Definitely, we do have resources, as you can see in our balance sheet. So, what we have done, we have increased already the initial spending for Upstream, so we were around RON 1.8 billion. Now, we spend around RON 2 billion for Upstream. And we are preparing for next year to spend further.

**Question from Oleg Galbur**: I will start with a follow-up on your production guidance for this year. Could you please tell us what the expected decline separately for crude oil and natural gas is?

**Answer from Christopher Veit**: on the declines, there is a significant difference actually between the oil production and the gas production. On oil, we see about 2% and on gas 9%, which is mainly driven by the fact that our big gas fields are off plateau already since 2017-2018. And since then, actually, they are in full decline; that is why we see a bigger decline actually on the gas production.

**Question from Oleg Galbur**: And going forward, since you were talking also about the mid-term or longer-term decline, would you still see oil production declining significantly less than the gas production?

**Answer from Christopher Veit**: Yes. Because here, we are very much over in the long-tail production scenario. This means the differences here are very small actually from year to year. The uncertainty also in the reservoir performance is much less actually than in gas reservoir. It is normal behavior that the decline is much faster by the end of production life.

**Question from Kian Huat Lim (CSAM):** I think a lot has been asked about your Upstream production. Can I check with you, given the latest status on both the oil and the gas production, does the company plan to update your production guidance for 2021 and subsequent years?

**Answer from Christopher Veit:** For the time being, we maintain our expectation in terms of Romanian production of around of 5% decline for the year 2022-2023, on average and we will update actually on the Capital Markets Day by end of the year.

**Question from Kian Huat Lim:** So, you view that the production for 2021 would still be achievable at roughly 5% decline year-on-year rate?

**Answer from Christina Verchere**: I think if I understand it right, your question is about 2021. And, we have said 6% decline for 2021. But for 2022 and 2023 we maintain our guidance for 5%. So, this year, because of the CAPEX that we have seen the last year and this year, we got a slightly steeper decline than we anticipated. However, for 2022 and 2023, we will return to what was anticipated in the past.

### 6. Upstream gas production vs. gas sales

**Question from Kian Huat Lim**: The next question that I have is regarding your volume of gas sold. In the Upstream, we see that the amount of gas sold fell roughly about 2% from 61.5 thousand of barrel equivalent per day to 60.2 thousand of barrel equivalent per day. So that is about just 2% of decline over the last quarter. But in Downstream Gas, we see that the production fell a lot sharper and this is from 14.36-terawatt hour to 11.21-terawatt hour. I understand that you had placed some gas in storage, which, looking at the amount of gas that was in storage in the last quarter versus this quarter, that is roughly about one terawatt hour. If we add back this one-terawatt hour to the amount of gas sold, we still get roughly a decline of 15% from Q1 to Q2. What I am trying to say is that the amount of gas sold adjusted for storage is about 15% for Downstream, whereas in Upstream we see that it is just very minimal 2%. Can we have more information about the discrepancy between these two decline figures?

**Answer from Franck Neel**: If I correctly understood your question, on Downstream Gas, we are selling also third-party gas, so we are trading gas on top of the equity, of our own production. So just to give you what our forecast for this year is to buy and sell 10-terawatt hour of gas on top of what we produce.

### 7. Special items related to Kazakhstan divestment

**Question from Oleg Galbur** could you provide more details on the special items that you booked in the quarter; and namely, explain the reason for the adjustments for the sale of assets in Kazakhstan as well as the personnel restructuring charges that you mentioned?

**Answer from Alina Popa:** Moving further to your question related to special items, in Q2 we have RON 403 million net special loss. This was driven mainly by two segments, Upstream around RON 116 million and then RON 300 million in Downstream Gas.

Now, in Upstream, and as I understood your question was rather towards the Upstream part. In Upstream, there were two main reasons. One was a loss related to the Kazakhstan subsidiaries. What we have there, we had foreign exchange differences recorded in other comprehensive income during the years according to IFRS, which needs to be recycled to P&L at divestment. So this foreign exchange losses recorded in equity was reflected in P&L and they were adjusted as special items in the profit and loss account.

And the second part of the special items was related to restructuring. We had booked restructuring costs related to our outsourcing activities in Upstream.

Related to the **special items in Downstream Gas** as the amount is quite significant. So, it is again related to the mark-to-market adjustments of our forward contracts for electricity booked in Downstream Gas. We had basically a year ago forward contract for electricity. Now the electricity price is very high, which means that mark-to-market adjustment for these contracts show a loss, which is a special item. The unrealized loss is treated as special item in the P&L presentation.

## Downstream Oil

### 8. MyAuchan: impact, margin

**Question from Irina Răilean**: My next question relates to MyAuchan project. You mentioned you plan to open 100 new stores by the end of the year. I would like to ask you, what impact should we expect for Downstream Oil from this project? If you could detail us on how much margin do you expect on the aggregate level or per store. It is a quite large project and it is also bit difficult to estimate its impact without any figures, guidelines. That is why I am asking.

**Answer from Radu Caprau (EB member responsible for Downstream Oil):** Indeed, Auchan is a very important project for the Petrom brand in Romania, not only from the size of investment, because it is approximately 50 million euro that we are going to invest together with Auchan, but also because it helps a lot the strong position of Petrom brand in Romania in the value for money segment, securing the three dimensions that we want to build on in this brand: reliable fuels, affordable prices, both for fuels and in the shops, and proximity of access, very close to Romanians. About the expected impact, what I would tell is that we have an ambition to have an increase of approximately 30% of our non-fuel margin in 2025. But that includes MyAuchan as well as other initiatives, so specifically for MyAuchan, I cannot go into details, but it is a very significant part of our ambition for 2025.

**Question from Irina Răilean:** It is 30% in 2025 compared to 2019?

**Answer from Radu Caprau:** yes 2019.

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