OMV Petrom Q4 2021 Conference Call – Q&A Transcript

OMV Petrom published its results for January – December 2021 on February 3, 2022. 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.

Question from Oleg Galbur (Raiffeisen International): I have two questions or in fact three but two are combined in the first one. It's about your production guidance for this year, where you assume a 7% decline excluding divestment or optimization. I was wondering first of all if you could provide the actual level of daily production that you expect in 2022 as well as the split between oil and gas, so that we make sure that we make the calculation so that we don't start from the wrong base. Also, I was trying to understand your guidance of 7% decline putting it in the perspective of the recently announced strategy, where you are targeting to reach a 3% decline by 2025. Also, I looked at last year's guidance for 2021 and 2022-23, where you were guiding for 5% decline from the existing portfolio. I was wondering, is this 7% a new level of decline that we should expect at least in the medium term, or this is rather an exceptionally high level of decline, and you are still targeting to reach 3% by 2025? This would be my first question.

The second question is on CAPEX guidance. If you could explain what is driving the almost two times increase of the downstream oil CAPEX this year.

Answer from Christina Verchere (CEO): I think Chris is well prepared to take questions on production, both what we saw last year, what we've seen this year and versus what we put out from December last year, as well as giving you some indication of the oil and gas nature of that. I think it becomes even more important in the context of some of the taxation levels that we're seeing here in Romania. And then Radu can jump in on CAPEX increase.

Answer from Christopher Veit (EB member Upstream): Yes, thank you Oleg for the question. Coming a little back on our production story, you know we are dealing with this natural decline very much in our fields and specifically in our gas fields, which plateaued since 2018, and are in full decline. And this was also reflected in the steeper decline we saw last year. This led us to the 7.6% decline, actually, which was mentioned. For 2022, we see this trend continuing. However, due to our higher investment volume that we have, we are trying to slow this trend down and we heard already that we're drilling now 60 wells compared to 36 wells last year and we hope that we can slow this trend down. However, these wells will not be fully operational already in 2022, so we will see the impact actually in the following year. We recognize this, what we communicated actually, the 3% excluding divestment, is a quite ambitious target. This depends very much on the results of the drilling this year and the workovers, we have planned some EOR new projects which should actually support this. So up to now, we are still holding on these numbers.

However, of course the investment climate on the gas, and we heard about the tax ratio which we see, leads to a big competitive disadvantage for the gas projects. So, we stick to the numbers and estimate the production volume for 2022 actually is around 116,000 boe/d.

Question from Oleg Galbur: Do you have also the split between oil and gas, please?

Answer from Christopher Veit: The oil and gas is still roughly half-half. A little bit more weight on the gas side but roughly 50/50, so it depends now very much on the economics of the project and of course we tend now to move more investment to the oil side, because the profitability of the gas side is much less through the higher taxation, actually.

Answer from Christina Verchere: Oleg, coming back to your second question, there is an increase in CAPEX in total Downstream. It's actually roughly flat in Downstream Oil but actually more in Downstream Gas, our newly named Gas and Power division, predominately driven by the Brazi two-month shutting in the first half of this year.

Question from Jonathan Lamb (Wood and Company): Part of my question was answered but it's about CAPEX. How much is going to be spent on the new PV projects and how much is going to be spent on the Brazi shutdown?

Alina Popa (CFO): So, for the PV we spend a bit below 100 million RON. Then the rest is for the shutdown in Brazi.

Question from Irina Răilean (Banca Transilvania): My first question is regarding your view on the natural gas market and when can we see a rebalancing or what should happen to see a rebalancing of the market?

The second question is also regarding your activity as last-resort supplier. I think ANRE announced something related to Petrom, but if you could detail a little bit on how this will impact the company.

My third question is regarding the additional dividends or extra dividends. Could we expect something like this towards maybe the summer or second half of the year?

Answer from Christina Verchere: Predicting gas prices, I think, is a question everybody is asking in highly volatile times. Frank, over to you on the natural gas and the last resort supplier, and then Alina will touch in on special dividends.

Answer from Franck Neel (EB member Downstream Gas): As you mentioned, we have seen quite a volatility of the gas prices we have never seen before last year. A rally on very high prices, and we've seen in December last year price reaching €180 per megawatt-hour, and the spot in Romania even very close to 1,000 RON per megawatt-hour. We have seen prices 900 RON per megawatt-hour, which is incredible.

On how sustainable it is, we don't think this level of price is sustainable because we will see some decrease on the demand side. Now, it's a supply-demand issue, so we need to see more gas coming also from the different interconnections that Romania has and that's really difficult to forecast anything on that in all the geopolitical context, due to when Nordstream will start, what will happen to the crisis in Ukraine, etc. Very hard to forecast but we don't think it's sustainable to stay on this high level. That we will certainly see a decrease. Now, winter is not finished. We are still at the beginning of February. So far, the forecast is rather for mild winter which would help, of course, also the gas price. However, let's see. Last year we had some cold spell even in April. If we stay with a mild winter, that will help of course.

On the question of last-resort supplier, yes, we are part of the supplier of last resort. But you know, it's capped at a certain number of customers, 30% of your portfolio. For us, as we are more a B2B supplier, 30% of our total portfolio is a limited number of customers. So far, we don't have any major impact. We don't forecast a major impact from that.

Answer from Alina Popa: In regard to the third question, indeed we have announced the possibility to have special dividends. This depends very much on the clarification of some uncertainties which are still there in our strategy, the biggest one being around timing of Neptun. Once we have clarified all these uncertainties, we will come back to the capital market with clarity around special dividends.

Question from Raphael Dubois (Société Générale): I have one on the refining business. Can you maybe help us understand how much of a burden has the utility cost increase been in Q4? That will be my first question.

Still in Downstream Oil, would it be possible to have a better feel for how the non-refining part of this business has evolved on a year-on-year basis? That would be a second question.

Sorry, but in Upstream, I still struggle to understand why the rise in gas prices is not bringing any extra contribution to your EBIT. It would appear that applying your sensitivity table, we are only seeing an increase in EBIT in Upstream from the rising oil price and nothing from gas. I understand it is heavily taxed, but could you remind us of what is happening in there?

Answer from Christina Verchere: I think we will definitely shed light on what is going on with gas taxation because you have a sense that is perfectly correct, there is no upside in the gas price reflected in our results, given the taxation position and Alina will go into more detail and also the advocacy work that we are doing to obviously get that changed. However, in the meantime let Radu provide you something on the refining and the retail question.

Answer from Radu Caprau (EB member Downstream Oil): On the utilities question indeed it was also clear for everybody that there was an impact in the industry, so from our perspective, as an indication, we can say that the impact is one digit million Euro. On non-fuel, it is actually when you say non-refining, it refers to the commercial or to the non-fuel? Just to make sure I understand the question properly?

Question from Raphael Dubois: It is mostly the commercial part of your business.

Answer from Radu Caprau: From this perspective, we had a good evolution, and we felt the benefit of the good recovery of the economy which of course was triggering a significant improvement of the demand. However, it is important to understand our position on the commercial business, we are partially covering our activities with equity production and the rest is based on third-party supply. Therefore, we are not necessarily running for the volumes here, but rather for the margins. And on margins we have very good contributions, which were reflected in the very good results of our activity. In conclusion, a good evolution reflected in demand, but we are especially capitalizing on margins.

Answer from Alina Popa: When it comes to the gas taxation, I will try to explain the three components. The first one is royalties, second is onshore taxation, and the third is offshore taxation.

When it comes to royalties and offshore taxation, there is an element which is called a reference price, and this means that the tax is paid on the reference price and not on realized price. What happened at the end of the year: the difference between the reference price, which is CEGH, and realized price was huge, from single to double in Q4. This led to a taxation which was significantly higher than in the past, and this we put now even more clearly on our sensitivity slide, that we have a sensitivity of €10-15 million for a change in €1/MWh of gas, but only if the reference price is moving in the same way as the realized price. Otherwise, this can go to zero or even negative levels. It is quite hard to estimate and to assess how these two prices will evolve. However, what we are doing is a significant advocacy with the authorities in Romania to change the basis for taxation, because we strongly believe it should be realized price and not a basis which has nothing to do with our revenues. We are in contact with authorities as we speak, and we hope to see this change as it impacts the gas projects in Romania.

Question from Alexander Burgansky (Renaissance Capital): I have two questions on upstream, please. The first one is, how many reserves did you lose by selling assets in Kazakhstan, so the proved reserves of those assets that you sold? Secondly, what was the reserve replacement ratio in 2021 excluding this disposal?

Answer from Christina Verchere: Thank you, Alexander. Chris, I think the RRR is for you.

Answer from Christopher Veit: Unfortunately, I do not have this number at hand at the moment.

Answer from Alina Popa: Let me come to the second question on the reserve replacement ratio. Now, if we refer to Romania, so the three-year reserve replacement ratio in Romania in 2021 was 27%. And if we go in the single year, Romania was 31%.

Also, I will follow-up on 1P reserves of Kazakhstan end of 2020, which stood at 22 mn boe.

Question from Alexander Burgansky: Sorry, can I just confirm you said 31% in one year?

Answer from Alina Popa: 31%, yes. Single year 2021, 31%. And three-year average, we publish both numbers, also Romania is 27%.

Answer from Christina Verchere: We have it in our Investor News, page 13.

Question from Alexander Burgansky: However, if I look into your last year's results, I am looking at your 2020 report, reserve replacement rates were 41% in 2020 and 49% in 2019. And if it is 31% in 2021, then how does that come to an average of 27%?

Christina Verchere: Let us take that offline and come back and clarify with you.

Alexander Burgansky: Alright.

Christina Verchere: It should be okay. However, we will check that and come back to you, if that is okay, Alexander?

Alexander Burgansky: Thank you.

Question from Tamas Pletser (Erste Bank): I have also got three questions. First of all, you mention that the decline of the production is mainly due to natural gas. How does it split between onshore and offshore gas, is it the same decline rate, or do you experience higher in one of the fields? That will be my first question.

My second question is regarding your indicator margin. I asked OMV today whether the indicator margin includes the cost of electricity and gas and they said “no”. Do you follow the same principle, is your indicator margin also ex-utility cost?

Finally, on Brazi upgrade, you mention the large part of the gas CAPEX will go to the Brazi upgrade. Can you elaborate why that cost is so high, that is a little bit surprising to me.

Answer from Chris Veit: Maybe on the first, yes, the decline rates are basically the same because all of these gas fields, the offshore and also onshore, they are all off the plateau, so more or less declines are similar. Of course, depending a little bit on each field, one more, one less. However, in general decline is the same for onshore and offshore.

Christina Verchere: Radu, do you want to cover the refining margin question?

Answer from Radu Caprau: We do use the same rationales. The way we deal with the refining margin, of course, considers the yields, the development of crude, which is relevant for the cost of fuel and loss which is factored in there. However, the utilities are not within the refining margin, utilities, and the CO2 cost, but they are part of our effort to make sure that we are managing to transfer them to the market. However, no, we do include those. We do the same, much like in OMV.

Answer from Franck Neel: In fact, you highlighted, it will be the biggest shutdown that we are doing with this power plant. It is two months. Usually, we have only a one-month shutdown. And here in two months, we are going to open the turbine. We are going to do some steam turbine renovation. It is really the biggest overhaul that we have ever done on the power plant, which is based on the long-term contract we have with GE in terms of maintenance. Thus, nothing abnormal. It is in line with the contract we have with them on this maintenance contract.

Question from Tamas Pletser: How much percentage of the maintenance cost of a new plant, because if I am not mistaken it is 10-20% of the cost of the new plant almost. Am I correct with this assumption?

Answer from Franck Neel: it is about €20 million this, the budget. Again, it is a budget. Also, we will see, but usually we stay on budget. It is €20 million, and the total plant cost was much higher than that, and we are talking about CAPEX which was above €500 million.

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