

OMV Petrom Q3 2022 Conference Call – Q&A Transcript

OMV Petrom published its results for January – September and Q3 2022 on October 28, 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, with edits for readability and clarification included in brackets.**

Question from Oleg Galbur (Raiffeisen Bank International): First of all, congratulations on the excellent result and thank you for your presentation. I have three questions. The first one relates to the dividend policy. Petrom's dividend policy was aligned, or is aligned, with the parent OMV dividend policy, and I wondered to which extent today's announcement of the special dividend at OMV and the intention of OMV's Board to amend the company's dividend policy could trigger a revision of Petrom's dividend policy. To put it differently, would Petrom's Executive Board see special dividends as more of a permanent or let us say regular way to reward shareholders, especially when the market environment is very supportive for earnings generation?

My second question relates to the gas and power business, which was extremely strong in the third quarter. Could you please help us understand to which extent this was rather a one-off quarter in terms of earnings generation, or maybe this is something that could be repeated, maybe not to this extent but still, in the next quarter or so? Moreover, could you please talk a bit about these gas transactions outside Romania so that we better understand their nature.

Last but not least, how do you see the regulatory changes in the power market in Romania changing the attractiveness of the power business for Petrom?

The last one is very short, on the outlook. Could you explain what has driven the revision of the production guidance for this year? Is it a smaller than expected decline of crude oil, or rather natural gas production?

Answer from Christina Verchere (CEO): Thank you for your questions. I will take the production guidance one and then Alina will cover dividend policy and the gas and power questions that you had.

I think you are right; we have actually changed our outlook for production decline to less than 6%. What we have seen obviously is we have been ramping up our drilling activity, and at the beginning of the year we were at four rigs – now we are at seven rigs. We have also seen that we had strong results on the gas side. So, we actually see the gas decline being less than the oil decline overall. And I would say also some strong performance on our planned shutdown activity that we have had, which has given us therefore the confidence to change our outlook for the remaining fourth quarter as well.

Answer from Alina Popa (CFO): I will continue with the dividend policy. With regards to your comment, Petrom and OMV are two separate companies with separate governance. We have our dividend policy approved and also, we came last year, together with the strategy announcement, with our dividend guidance, and basically substance for Petrom is {that}we are talking about a progressive dividend policy where we specifically indicated the guidance of 5-10% increase of the base dividend every year, depending of course on the economic environment and provided our CAPEX plans are being funded.

And also, together with our strategy in December last year we have announced the possibility of special dividends. That again depending on the financial performance of the company and the market environment. Furthermore, as you know, in this summer we have announced and approved in the general meeting of shareholders our first special dividend, which has been started being paid in September. So, from this perspective I believe our dividend guidance is quite clear going forward.

Going to your second question, which was quite a complex one, covers several topics, I'll try to cover it the best I can. So, with regards to this quarter indeed it was a very special quarter. So, we had a very good result both for gas and for power. And if I refer to your question, to what extent was it a one-off quarter, indeed it was something very

special in this quarter. What we did, we purchased gas from outside Romania in the first two quarters at quite lower prices and we managed to sell this at quite high prices in Q3. So, we did quite a significant margin from these transactions outside Romania. We have announced, maybe you remember together with our strategy, that we will not only remain focused on Romania, but also on the region when it comes to gas. And due to the environment, which was extremely volatile, we managed to achieve quite a good result.

Now, it is very hard to imagine that this will be repeated to the same extent. Definitely from a substance perspective, we will continue to do regional transactions, so this will be continued, but it depends a lot on how the prices will evolve when it comes to the impact. Now, to give you a bit of guidance, almost half of the Gas and Power result of this quarter is coming from these gas transactions outside Romania.

And when it comes to how do we see the regulatory changes and attractiveness of the Power {segment}, this is a very difficult question. We have a lot of unclarities right now when it comes to Ordinance 119. These are the changes that were made. Now we are trying to still clarify various things, so it is really very difficult to comment as we do not have the full understanding. We believe in the Power business, and we will try to take the best decision going forward, but it will depend a lot on how regulations will be. Every time we do the judgement, we are using this optimization model, so making the call what is the best: put the gas in the power plant, or to sell it as such on the gas market, gas market also being regulated now, in Q4 both gas and power markets are being regulated to a large extent.

I hope I covered your questions.

Question from Oleg Galbur: Yes indeed, thank you very much. And maybe just one short follow-up on these gas transactions outside Romania. Did Petrom place all the volumes that were contracted in the first two quarters or were all these volumes sold in the third quarter or there is still room to see more transactions in the fourth quarter?

Answer from Alina Popa: To a large majority, yes, they were realized in the third quarter.

Question from Ioana Andrei (Alpha Bank): My first question was related to this trading activity abroad, so I'll go further on. Can you please tell us what are the required regulated gas sales for the next year? Can you give us a clue on that?

And further on, if you can please detail the estimated impact of the regulation on the power side. Can you please give us something more on this side?

And my third question is related to the EU solidarity contribution for fossil fuels. Can you please tell us what is your take on that and what are your expectations?

Answer from Christina Verchere: Maybe Alina will cover the regulatory sales of 2023, although I think it's actually very hard at this point in time to be able to quantify that. But also, the impact on the power side. But maybe first I'll start with the EU solidarity tax.

I think fundamental principles that are important for us actually is we do fundamentally believe, obviously, in free market principles. We see a lot of regulation going on. We also really recognize that we are in really unprecedented times right now and therefore there is a strong need to protect vulnerable consumers overall. What we do obviously seek is good consultation with the industry and good impact assessments of that, because we fundamentally believe that for the long run, free-market principles should{prevail}, because this is actually what allows the strongest level for investments to occur and investment, we believe, is part of the solution with regard to increased capacities overall.

With regards to the EU solidarity contribution, I think the fundamental aspect here is that a lot of interventions have been made in Romania already, as we've been talking about, too. And therefore, we see that the contributions from a solidarity perspective are already being built in. But this is something that is an ongoing discussion within Romania and not yet clarified. But as you said, Romania is one of the highest taxed countries within the EU with regards to

oil, gas and now power already being in place. And as we said, you can see that in the level of taxes that we are paying here in Romania right now.

Answer from Alina Popa: With regards to the regulated gas sales from next year, we do not have an indication at this point in time. However, if I would refer to sales to households and district heating companies in Q3, we're talking about 10%, a little below 10%. This will grow into Q4, but for next year we do not have an estimation at this point in time.

With regards to your question related to the impact of the regulation on the power side, in Q3 we have an impact of approximately RON 600 million. Going forward we do not have an estimation. Again, there are a lot of questions around how this will continue.

Question from Irina Railean (BT Capital Partners): I have four questions, especially on the gas business. I have heard many percentage figures in this call regarding the sales mix and I just wanted to understand on slide 5, I have here a suite of your gas portfolio and I just wanted to know is this out from G&P or from your equity production?

I'm just trying to understand on what volumes to apply these percentages. And if you have revised the guidance for regulated volumes in the fourth quarter? From the last call, I remember something like 3.4 terawatt {hour} for the entire period April-December. But applying this 34% on the G&P total volumes results in a pretty high figure, so I want just to know how correctly to apply these percentages and if you have revised your guidance for the fourth quarter? And this 80% that has been mentioned, is it also of equity gas or of total sales in the G&P? That would be verification on this side.

And one more question regarding the limit on trading activity. Do you have any clearance here? Would this apply also to volumes sold outside Romania or only on trading activities performed in Romania?

Answer from Alina Popa: I'll try to cover the best I can, Irina, and if there is anything, please tell me again. So, when we present the pie with split of regulated volumes, it refers to the total sales volume, not only to the equity {part}

You ask about the fourth quarter. We do not provide exactly on the fourth quarter. I said third quarter is approximately, if we think about household and district heating, it's about 10%, slightly below 10%. Fourth quarter will be higher than that.

Question from Irina Railean: What is then this 34%? Because it's regulated and you also mentioned 10%.

Answer from Alina Popa: Let me explain that. When we talk about regulated, we refer not only to households and district heating, {but we also} refer to what portion of our sales is affected by the legislation in one way or another. And we are affected by the legislation in various forms. First of all, sales to households and district heating. Then we have sales to end users, to categories of end users small and big, but both of them are regulated. Small ones with a cap, bigger ones with a cost plus. And then we have also gas, which is purchased and sold, gas which we are trading {in Romania}, where we pay this trading tax.

So, from this perspective it comes our indication that our sales of gas impacted by legislation {are to} increase from 45% overall in Q3 to 80% overall in Q4. And also, to mention Brazi. Also, on Brazi, we are regulated now because sales to Brazi are done with a cap of RON 100, so also there. And in Q3 we had only one month which was affected by this, in Q4 we will have all three months, that's why the sales of gas which will be affected in different ways by legislation go to around 80% in Q4.

Question from Irina Railean: Okay, so out of this 34%, only 10% is to households and heating plants? And the remaining volume also includes traded volumes?

Answer from Alina Popa: Yes.

Question from Irina Railean: Okay. So, you maintain your guidance of 3.4 terawatt hours for gas sold to households and district heating plants for this year?

Answer from Alina Popa: When we say regulated sales, total regulated sales, sales affected by legislation, we are broader than that. That does not cover only households and district heating. I think here is the confusion.

Question from Irina Railean: Okay, so your 3.4 previous guidance is also on top of regulated volumes?

Answer from Alina Popa: It's only referring to households.

Irina Railean: Okay, I understand now. Thank you.

Answer from Alina Popa: And with regards to your last question related to the trading outside Romania, the regulation was issued with a purpose to protect the Romanian gas and power market. Consequently, in our view transactions outside Romania are not subject to this contribution.

Question from Tamas Pletser (Erste Investment): My question is related to your Neptun investment. What kind of point do you still have a disagreement {on as to} the Romanian legislation about investing into Neptun? What are the areas where you need further clarification or further confirmation from the government to go ahead with this investment?

Answer from Christina Verchere: As I said in my presentation, we became operator on 1st August after the completion of the Romgaz and Exxon transaction. We have built up a strong team that we've had in place actually for some time now, so moving things forward at pace. We actually do see some need for clarifications ultimately related around the free-market provision and just understanding what that means. You can obviously understand even in the context of today of what's going on, the importance of understanding the free-market aspects with regards to this investment.

Please be assured that we are also working at the same time to the procurement process, to be able to clarify the costs on the tendering side and with that, to then be able to move forward to the internal governance, which is why we put ourselves at a mid-2023 FID decision, which is what we're aiming towards.

Question from Tamas Pletser: Have you agreed everything with the government on this in that method? Or what do you mean by this free-market provision? What problems do you see with this kind of assumption?

Answer from Christina Verchere: So, first of all, obviously the government legislates and that is a decision that the government makes. What we're looking to clarify is that there is an article in the offshore law, I think it's Article 21, which is trying to stipulate where free market exists and where some of the step-aways from free market can occur, and it's around this that we want to understand clarifications with regards to ultimately the stability that we can expect as we move into this investment decision.

Question from Iuliana Ciopraga (Wood & Company): I have a couple of questions, also most of them related to gas. So just to clarify the chart on page 5 refers to upstream gas sales excluding the trading of gas outside Romania?

And secondly can you disclose the average realized price for the 34% sold on the regulated market? And also, regarding the sales on the free market, do they follow the realized price on the BRM?

And another question on the special dividend. Was it paid because of good performance in 2021 or when? What's the cut-off date for the special dividend?

Answer from Alina Popa: So, the pie refers to total sales, Iuliana. Total sales including everything. Including sales outside Romania.

I'm not sure if I captured correctly your other two questions. They were around realized price of gas, right?

Question from Iuliana Ciopraga: Realized price of gas for the 34% sold on the regulated market, which now I understand that it refers to the 10 terawatts sold in the third quarter, so everything including the trading outside of Romania. I mean if you included those volumes here in this graph.

Answer from Alina Popa: Yes, we did. When it comes to the realized price, we do not publish our realized gas price. It follows the market price to a good extent, but always lower than the market price as we have quantities which are sold at regulated prices and also quantities which are coming from contracts which were done in the previous periods.

Question from Iuliana Ciopraga: I was referring just to the regulated market, what you define as regulated market.

Answer from Alina Popa: It's very hard to give a number. I mean, we have a combination of sales in this regulated chapter. Some of them are straightforward because they are {at} 150 and 250 {RON/MWh} that we all know, but we also have some cost-plus quantities.

Question from Iuliana Ciopraga: In the cost-plus, is it upstream cost plus, or what cost?

Answer from Alina Popa: It is the transfer price plus all the other costs in Gas and Power division. It's not the upstream cost plus.

Question from Iuliana Ciopraga: And the transfer price, what does it follow? It follows the sales on the free market.

Answer from Alina Popa: Basically, I cannot provide more details on that, but we always try to benchmark the best with the market price. Like if the E&P and Gas and Power would be two separate entities, we try to picture that in our transfer price logic between the two divisions. And also, to consider, we have also gas purchased from third parties, which is sold with cost-plus mechanism. So, it's a combination, it's not only equity.

Answer from Christina Verchere: On the special dividends, we announced our special dividend in June of this year, paid it in September of this year. I think it's a combination of effects with regards to it. Obviously, it is linked to the prior year's performance, but also overall ensuring of funding of our investments, moving our strategy forward, at the same time wanting to make sure we return some of these upside opportunities to the shareholders.

Question from Daniela Mandru (Swiss Capital): I have a question related to the realized gas price in the E&P. I'd like to do together and you the management to help us to underpin the rationale of the trend in these prices. So, for example the question is, in the third quarter the realized gas price decreased, or increased? What is the rationale behind this? And what is the outlook for the last quarter? So please if you can help us.

And the other one would be related to CAPEX, because from your outlook I understood that the RON 4 billion forecasted CAPEX will depend on the investment climate, and I would wonder what would be the variables impacting the CAPEX in the last quarter of the year?

Answer from Alina Popa: So, with regards to the realized prices, quite complex. It is a combination of the structure of our gas – so we have different categories, so it's quite complex to comment overall. If I would refer to Q4, we expect a decrease in realized gas price {qoq}, triggered by two dimensions. On one hand we see already market price going down but even more important than that, the portion of regulated quantities is increasing in Q4. The fact that sales of gas to the power plant in Q4 will be affected by this regulation three months. So, if we had only one month in Q3, meaning that sales to power plant were approximately 30%, that would beat RON 100 per megawatt {cap}. But also, that regulated sales in Q4 are increasing, with the winter coming, households and district heating need more gas. Consequently, that part is also increasing. Having in mind that our district heating customers also moved from 250 to 150. So overall as a trend, Daniela, {the G&P realized gas price} will decrease.

Daniela Mandru: Okay, so this confirms our intuition.

Answer from Alina Popa: Okay, just one more. When I'm saying 'decrease', I refer versus Q3. If we would compare to the Q4 of last year, it would be still higher.

Question from Daniela Mandru: Yes, but Q3 compared with the second quarter of this year: increase or decrease?

Answer from Alina Popa: Q3 {G&P realized gas price} went slightly up

Question from Daniela Mandru: Yes, quarter on quarter slightly up. So, in the third quarter the realized gas price in the E&P increased compared to the second quarter.

Alina Popa: Yes {in G&P it went up}

Question from Daniela Mandru: Mainly helped by, probably, the free-market prices?

Answer from Alina Popa: Yes. Because the free-market prices had a bigger impact in Q3. However, affected by legislation overall.

{Please note that in E&P it went slightly down due to higher weight of regulated gas sales volumes}.

Answer from Christina Verchere: On your CAPEX question that you had, maybe I'll just bring a couple of points. I think what you can actually see is we do continue to see CAPEX ramping up, driven by the increase in drilling activity from the first quarter. We were at four rigs, now we're at seven rigs.

I think with regards to investment climate, I think we just also need to recognize that we have a combination of factors going on, particularly that might impact E&P. In the supply chain, we are seeing cost pressures, so we are seeing overall cost pressures and at the same time we are seeing regulated prices and a lot of volatility. And so, the combination of those, our goal will always be to make sure that we have robust economic decisions in making our investments in the context of, as I said, increasing costs and volatility and the regulatory environment, which is obviously our ability to predict what we think will happen with pricing. And those are the factors that we need to take into consideration. As you would expect, because we are a very capital-disciplined company.

Question from Daniela Mandru: Thank you. So, the follow-up question would be, this RON 4 billion CAPEX for the full year is your base case scenario or the optimistic case scenario? And what would be the worst-case scenario?

Answer from Christina Verchere: At this point, Daniela, we just provide one scenario on our outlook and that is what we've included in our outlook. The only comment I would make obviously is that there is a fair amount of volatility, which we all also need to take into consideration as we make investment decisions.

Question from Ioana Andrei: I have a follow-up question with regards to gas side. Considering the fact that we started the next gas year, or at least are soon starting, can you please give us some clues on how much of the volumes are already secured? And if prices for the next year should reflect the high third-quarter pricing environment or more rather the quite steep downturn from the last couple of days?

Answer from Alina Popa: We have a lot of questions around next year ourselves, so we have a lot of unclarity around regulation. So, we do not know yet the regulated quantities for next year. When it comes to prices, as you can see, the volatility is huge, even between Q3 and Q4 it's incredible. So overall we see prices at a high level, but we cannot indicate anything more than that.

Question from Ioana Andrei: Yes, but what I was actually trying to find out, if you're already selling gas for the next year on the free market. Not on the regulated side – besides the regulated side.

Answer from Alina Popa: Very little. So, by comparison with the past, everybody's waiting to see how the legislation will finally remain for next year. So, what we see is with most of our customers we do have contracts until end of December and there is not much done for next year on the free market.

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