OMV Petrom Neptun Deep FID Conference Call – Q&A Transcript

On 21 June 2023, OMV Petrom announced via an ad-hoc report the FID for Neptun Deep. The investor and analyst conference call was broadcasted as a live webcast on 22 June 2023, at 3:00 pm local time. **Below is the transcript of the question-and-answer session, with edits for readability and clarifications/additions included in brackets.**

Questions from Jonathan Lamb (Wood & Co): Good afternoon, congratulations. It's a great day. I want to ask you about the availability of everything to make this thing happen on time. Do you already have the drilling rig booked and all the engineering companies, contractors ready to go in and start?

Answer from Christina Verchere (CEO): Thank you for joining to us. Yes, we agree, it's a great moment today. With regards to the tendering process, Cristi will take your question.

Answer from Cristian Hubati (EB member E&P): We are just now in the final process of tendering. We didn't award the final packages as we are waiting for the validation of the field development plan submitted to the regulator. But we're ready.

Answer from Alina Popa (CFO): Hello, Jonathan also from my side, very happy as well that we share with you this great moment for us. I would say with regards to availability, we do have options, we do have competitive process, so we are very confident that we will be able to keep the timeline and have the first gas in 2027, based on what we have on the table right now.

Questions from Raphael Dubois (Societe Generale): First of all, let me congratulate you for taking FID on Neptun. I have a few questions, please. The first one is: is there a tax stability agreement that has been signed with Romania? We have seen the windfall taxation being imposed, so it would be great to know if there is any stability that can be expected.

Second question is, I understand the growing volumes, the lower opex/boe. But in the end, can you address whether we should expect flat or better EBIT per boe in your upstream division? And same question for the cash flow per boe that would be helpful.

And lastly, have you signed any offtake agreements yet? Or is this something that you will focus on now that the FID has been taken?

Answer from Christina Verchere: Thank you, Raphael for your kind words. For your first two questions on tax stability and sort of the improvement to the EBIT and the cash flow, Alina will cover those and then Franck will talk about your question on offtake agreements.

Answer from Alina Popa: Hello from my side, Raphael, as well. So, talking about the tax, we do have the Offshore Law with some stability principles. Also, there is a concession agreement with some stability [clauses in] there. As we mentioned with regards to Offshore Law, there are still some clarifications, which are going on, but in principal, with regards to tax, we do have stability there. And we will continue to advocate on how important stability and predictability are along the journey of this project. I think this is our job to do in order to make sure that this is maintained going forward.

With regards to your second question around EBIT and cash flow predictability, we do have, of course, a lot of volatility around pricing. With regards to volumes, we mentioned that after the first year, we will reach the plateau, which will be a very stable production over almost 10 years, but of course, we have the pricing element, and price risk, which we are happy to take as an investor in this industry. And it depends on how you see the pricing, you might have some volatility over the years.

Answer from Franck Neel (EB member G&P): Thank you for your question. And as you follow OMV Petrom since many years, you know that in the last years, the gas and power team has built the capability in terms of marketing, in terms of trading, in terms of licensing, of course, in Romania, but also in Southeast Europe. So, I'm very confident with my team in terms of the possibility to market this gas. But of course, due to the competition law and the fact our partner, Romgaz, is also our main competitor on the market, I cannot disclose commercial information, as you can imagine. What I can tell you in terms of what we are looking at is that, due to its proximity, Romania stands out as an attractive market, but we are also actively exploring available options within the European Union. We have an expectation that, due to the supply and demand, the market will be long in Romania, so export will need to be available. But also, we are very confident in the last four years, given the development of the interconnection between Romania and the neighboring countries. I think the TSO, Transgaz has done a great job there. So, we have available capacity in the different neighboring countries, which gives us also the security that we will not be in a trapped market, if there is another supply. So, I think that's what's important for us to take also FID.

Question from Yuriy Kukhtanych (Millennium Capital Partners): first of all, thank you for your time and congratulations on FID project finally, after years of hesitation. I have three questions, but the first question, it's a clarification. So, you said, you took the FID as the company, as far as I understand, with Romgaz together, but the FID is not approved yet by the government. So, if you could just clarify what needs to be done and what do you expect from the government? Is it just a formality or they still have to do and to approve some details, specificities about the project itself? So that's question number one. Second question is on capex. You mentioned it's still EUR 4 billion. However, you said that you haven't granted the contracts yet. I understand that big proportion of this capex is still not contracted. So, this EUR 4 billion is a very old figure. So how much confidence do you have that this is going to be EUR 4 billion, not more, especially in a highly inflationary environment that you live? We hear from every oil and gas company in the world, the costs are going up by 20%-25% for new developments. So how can you be confident in this EUR 4 billion capex figure?

And the third question is on the security situation in the Black Sea. Given the proximity of the project to the war zone in Ukraine and in the Black Sea, what extra steps do you need to take to ensure security of development and security of infrastructure? And how much will it cost you?

Answer from Christina Verchere: I will take the first question on FID versus FDP. It's a very fair question to explain. Alina is going to cover the capex with regards to the tendering, and Cristi will cover the question with regards to the Black Sea. So, the final investment decision is a decision that obviously was taken by the company. Once the company has made that decision, it then has the ability to vote with the joint venture partner, and we voted with the joint venture partner that we were ready to submit the field development plan. So the field development plan has been submitted for endorsement, and we will wait for approval on that. Clearly, we have been in dialogue with the regulator. So, we are looking for a speedy decision with that, and then from that, we will be able to do the contract awards. The regulator has 90 days to do that, and we are hopeful that they will do it much shorter than that, given we have been having dialogue beforehand. Alina, next question to you.

Answer from Alina Popa: And with regards to capex, we are indeed very happy, and we work hard to stay below the EUR 4 billion that we indicated when we launched our strategy. Right now, we have approximately 70% to 80% of this capex either based on preliminary offers or best and final offers. So, we are quite confident that we will be able to stay below the EUR 4 billion, that's why we reconfirmed our indication of two years ago.

Answer from Cristian Hubati: As you know, we are operating, as we speak, in the Black Sea since more than 40 years. Of course, during the actual operation and during the project, we, as a prudent operator, will take all the necessary measures to perform safe operation. Of course, for the moment, we are not seeing any operation interruption in the Black Sea due to the Russia-Ukraine conflict. And of course, we are not seeing any risk for the development of the Neptun Deep due to this conflict.

Answer from Christina Verchere: I mean, I think it's a very fair question, and we've obviously dialogued a lot with regards to this overall. And the only other point I would say is, obviously, we're in dialogue with the Romanian authorities with regards to this. And obviously, a very important fact, is that Romania is a NATO country.

Question from Iuliana Ciopraga (Wood & Co): Good afternoon and congratulations for the FID. First, regarding the provisions on the Offshore Law where you wanted clarifications. Can you let us know what is happening on this side? And second, the 12% IRR, what price is that based on? And my third question would be, how much does it cost or would it cost you to export the gas?

Answer from Christina Verchere: I'll take the first question. Alina, the second one, and Franck will take the third one of that. You're absolutely right, we have been working hard to get some clarifications with regards to the Offshore Law that was actually passed in May of 2022, so we've been working on this for over a year. We haven't actually got the necessary clarifications. So to avoid any delay in the investment decision, we are applying a resolution mechanism that exists in the petroleum concession agreement to seek clarification for that. However, this is not in any way impacting the pace of the project. And as a company, we are confident that once matters are clarified that this topic will also be settled for that. Alina, on the IRR?

Answer from Alina Popa: To mention first that we are talking about full cycle IRR, that's an important element. So you need to add to this future cost that we disclosed of around EUR 4 billion, if we talk about 100%, all the past costs as well. So that's the first clarification. And then with regards to prices, you know we do not disclose our realized prices, yes. That's the practice we do for everything. But in principle, what we see the prices are and what we expect for the time when Neptun Deep will come on stream is that prices will be more and more aligned with the European hub prices. Our estimations for hub prices, which are somewhere between EUR 25 to EUR 30 per megawatt-hour starting 2027. And I think that hub prices are what you need to calculate the rest, but we do not disclose exactly the realized prices. Thank you.

Answer from Franck Neel: On your export question, I think it's a bit more complex than that. I think it depends on the spread between markets. Now if you refer to the interconnection costs between markets, it depends on which market we are talking about. But usually, it is between EUR 1.5-2 per megawatt hour, the interconnection cost to exit the country, and then you have variable cost as well, based on the gas volume.

Question from Tamas Pletser (Erste Group): I got two questions. First of all, can you just tell us a little bit about the production profile of this project? I remember you mentioned during the presentation that you expect the plateau production around 140,000 barrels per day. When do you expect to reach that level? And how do you expect later on the decline of this production going forward? That would be my first question.

And my second question would be about the kind of production of this gas. Do you share this gas with Romgaz? Or do you sell together this gas, what you produce from this project company? So how can we imagine the sale process of the produced gas?

Answer from Christina Verchere: Cristi will take your questions with regards to the production profile, and obviously, when it comes to selling gas, Franck will cover this.

Answer from Cristian Hubati: You are right, production profile is showing a plateau of 140,000 boe per day. We are expecting to reach this in 2028. Production profile: plateau will stay 10 years, and after that it will gradually decline for the next eight years.

Answer from Franck Neel: So, with our partner, Romgaz, the volume of gas will be shared based on our participation, so 50-50%. We will all be responsible, each of the parties for the marketing of their gas. Separately.

Question from Oleg Galbur (Raiffeisen): I have three questions. The first one is based on the projected level of production, what level of royalties do you expect to pay on Neptun Deep output of production?

Second question refers to capex. Could you please provide an approximate annual split of this EUR 4 billion?

And thirdly, in order to be able to actually sell the gas produced at Neptun Deep, would it be necessary for any additional infrastructure to be developed by outside parties like Transgaz, for example?

Answer from Christina Verchere: Alina will cover the first two on royalties and capex, and then Franck will talk about any additional infrastructure needed for selling the gas.

Answer from Alina Popa: With regards to your first question, based on the level of production, we will have an applicable rate of 13% for royalties. With regards to the second question, it's too early for us to have a capex split per year. We are really in the middle of the procurement process. There will be intensive discussions over the next few months, so it's too early and I am not able to provide this to you today.

Answer from Franck Neel: for your question related to the infrastructure. Yes, there is still a piece of infrastructure and there was an announcement in the last weeks. Indeed, between when the gas arrived in Tuzla, we need to connect Tuzla to Podisor. And I think what is important with this infrastructure is it gives us also access to different markets because you connect to T1 [transit line], which is a trans-Balkan route which is going north to south. It's connected then to the National Transmission System of Romania, but also connected to the BRUA pipeline. So it's a very important infrastructure. The EPC contractor has been already selected by Transgaz; the contract has been signed. And the expectation from the EPC contractors is by the end of 2025, this piece of infrastructure would be delivered.

Question from Yuriy Kukhtanych: I have two follow-ups, please. Christina, you said that the process of approval can take 90 days. Did I understand correctly? Just if you could talk about optionality here? I mean what's the approval process? What do they need to do? Because I still don't understand that, the Offshore Law I understand is done. You don't have any comments to the Offshore Law. So that's my first question, if it is just a clarification, why is it 90 days? Why is it so much, so long? And second follow-up is on pricing. Does the government still have the first right of purchase of gas according to the draft of Offshore Law from last year, I think? Or you will be selling the gas on the open market?

Answer from Christina Verchere: I'll cover the first question and then Franck will talk about the Article 21 and right to first offer. 90 days is what's written into the regulation [concession agreement] and it's the right of the regulator to take that. Ultimately, they're reviewing the field development plan, the resources that will be developed, to sign off on it. That's not uncommon around the world. Obviously, we've been working closely with the regulators, so what's coming in is not a surprise to them, and we are hopeful that they will be able to do it in less time to them. But it's their right to take 90 days to look at it, so how it's written in the regulation [concession agreement]. And I think that's not unique to Neptun Deep. That's just how it's written. So hopefully, that answers your question.

Question from Yuriy Kukhtanych: Christina, sorry. And do you have all the environmental permits already from the government, everything is approved? Or there is still something that needs to be approved by the government? Or it's just an FID revision?

Answer from Christina Verchere: So, the field development plan is about how you plan to develop the field. It's not about the permitting. The permitting and the different permits is a separate process and done by actually different regulators. If you can imagine, it's done by different regulators.

Question from Yuriy Kukhtanych: You don't have environmental permits?

Answer from Christina Verchere: Okay. We can talk through that, and Cristi can talk where we are with regards to the environmental permits.

Answer from Cristian Hubati: As you probably know, you cannot apply, you cannot have a construction permit, and hence the environmental permit, as long as you don't have the field development plan approved and final. We're in the process. We applied for the environmental permit. We are aligned with the authorities. There were several meetings and technical committees. We are well on track; we are not seeing hiccups because of this process. But you cannot have, basically, those permits before the approval of the project. I mean the FDP from the regulator.

Question from Yuriy Kukhtanych: I can give you the example of Rosebank in the UK, which is exactly the reason why they are not FID project. The Rosebank in the UK, because they haven't received the environmental permits for the project.

Answer from Christina Verchere: Yuri, I can understand obviously different things around the world. What we have, and I think we've had this conversation in the past, what we see is, given the national importance of this project, all relevant Romanian authorities are very keen to see it moved forward at pace. We had a joint press conference this morning with the Prime Minister, the President of the Senate, as well as OMV Petrom and Romgaz. And I think we see a lot of national support to move this project through at pace. So that's just one piece of color that I would add. Obviously, I'm not saying necessarily that it makes different from the UK, but this obviously is a game changer, not just for the company, but also for the country as well.

Question from Yuriy Kukhtanych: and on the government right of first to purchase?

Answer from Franck Neel: So, in the Article 21 of the Offshore Law, the titleholders have to propose to the state agency the possibility to match the offer we have on the market. So, it's not a preemption, but it's the possibility to match the offers we have on the market.

Question from Yuriy Kukhtanych: So, it is still there. It's still in the contract, in the law. You have to offer volumes to the government first before you sell it on the open market.

Answer from Franck Neel: Yes, this is correct. But it's based on the offer we receive as well. So, they will have to match the conditions we receive from the market, from what offers the buyer.

Question from Daniela Mândru: I have only one question regarding the net present value of the project because it is very important. I have an estimated value of EUR 4 billion. Please confirm me that I'm not out a lot of your range.

Answer from Alina Popa: I'm very, very happy that we hear you and you could be today with us. Unfortunately, I will not be able to disclose the net present value, but what I can say is that you have all the relevant information there, the only one which is, of course, there are many opinions that could exist, is the gas price, but otherwise, you have the future capex, you have the past capex as well, you have the operating cost, and depending on the production profile and depending on the gas price, and of course, the discount rate, you can calculate, the net present value, but I'm not in a position to be able to disclose this to you.

Question from Daniela Mândru: Then regarding the own consumption of technological loss, my assumption is around 6%, 5.7%. I know you have a higher technological rate compared with Romgaz that's why I'm confused. I don't know what rate to use.

Answer from Alina Popa: I think that is not relevant for Neptun, but we do not disclose any kind of technological loss or anything like that. What you refer to is about our onshore, our traditional business, which is very different than this project.

Question from Daniela Mândru: So, it would be lower compared to the onshore business?

Answer from Alina Popa: Yes.

Question from Oleg Galbur: I do have a small follow-up. Just if you can clarify from your press release, you mentioned that the 100 billion cubic meters of recoverable reserves are a gross number. I wanted to ask if the 140,000 boe of daily production is also a gross figure or a net figure? How should we look at it?

Answer from Christina Verchere: They're both gross. Yes. 100 billion is gross and 140,000 barrels a day is also gross, so we would be 50% of that.

Question from Iuliana Ciopraga: Just a clarification, actually, to the 12% IRR, I guess, this is based on the EUR 25-30 per megawatt-hour that you are mentioning? And my second question would be actually regarding opex. On the opex side, and that USD 3 per boe: is that based on binding offers as well? Is that something that you're looking to contract right now? How would that work guarantee this USD 3 per boe?

Answer from Christina Verchere: Maybe just, Alina, you can take the first question. On the second question, the opex is the operating cost, what's tendering right now is the capex costs, so they are quite different costs, because the opex is really the operational side of it. It doesn't include royalties, it doesn't include depreciation or anything like that, so it's quite a different kind of cost than the capex. So, it's not linked to the tendering side of it.

Question from Iuliana Ciopraga: But how would you guarantee that? I mean, how are you going to sign a contract right now to guarantee these USD 3 per boe? How would that work? Or is it just operating costs, it's something internal related to Petrom?

Answer from Christina Verchere: Yes. It's an operating cost related to OMV Petrom and the running of the equipment that you saw on the video and all those aspects that you would see.

Question from Iuliana Ciopraga: So, it's not based on contractors. Okay. Thank you.

Answer from Alina Popa: With regards to the 12% IRR, we mentioned in our strategy that the hurdle rate is minimum 12%, and we wanted to confirm that on full cycle basis, this project is above the 12%. Yes, indeed, 12% is calculated with a hub price of EUR 25 to 30 per megawatt-hour. We do a lot of scenarios with regards to pricing, that's absolutely the case and sensitivities and so on. But I can confirm that with a hub price of around EUR 25 to 30, we reach above 12% IRR.

Question from Raphael Dubois: So just maybe let me ask differently, if Neptun would be working at capacity now, would you be at plateau with Neptun, how would the EBIT per boe compare with the rest of your upstream business? Just to have a feel for the increase in the gas exposure, the lower opex per boe, how does it end up?

Answer from Alina Popa: Thank you, Raphael, for the follow-up. I can confirm that considering lower costs coming from Neptun Deep, if this would have been today onstream, our EBIT per boe generated by Neptun would be significantly higher than the rest of the portfolio.

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