



OMV Petrom Q2 2018 Conference Call – Q&A Transcript

OMV Petrom published its results for Q2/18 and January – June 2018 on August 2, 2018. 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. Net financial loss

Question from Alexander Burgansky (Renaissance Capital): Can you please explain what the fiscal review was about? Also there was quite a high negative financial expense reported in the second quarter of RON 183 million. Can you please elaborate on why it has increased so significantly?

Answer from Stefan Waldner (CFO): The financial expense in the second quarter increased mainly for two reasons. One is related to a long term receivable that we have on our balance sheet that you are probably aware of. As interest rates increased in Romania, also the discount rates that we have to apply under IFRS increased. Thus the net present value of future receivables actually went down, which is a negative impact, and in the P&L it shows under the financial expenses. This is a non-cash effect related to that increase in interest rate.

And the second effect is actually related to the tax audit that you mentioned. We recently finalized the tax audit that covered three years: 2011, 2012 and 2013, with tax findings of late payment interest that we booked also in Q2 2018.

And for completeness, because you see a relatively high level of financial expenses, even though we actually have very limited external debt, there is a third reason that is also shown here, which is the so-called unwinding effect of provisions. We have obviously quite sizeable decommissioning provisions on our balance sheet. And as we move closer to the point of decommissioning, we are building up that provision and the time value of money effect of that is also shown in the interest expense line.

Thus, if you look at the Q2 interest expenses of RON 180 million, those three topics are each about a third of that amount.

Question from Yuriy Kukhtanych (Deutsche Bank): I understand that there was a one-off charge in your tax of around RON 55 million regarding sales in 2011- 2013 and that was imposed by the authorities. What is the mechanism here, do you have to pay it in cash or it is just a recognition of the past tax that has already been paid? Could you clarify that and how should I actually think about these extra taxes for the prior period going forward.

Answer from Stefan Waldner: This was a much extended tax audit for the years 2011, 2012, 2013. I should point out this is still a preliminary report, thus the final outcome may still change slightly. This will lead to cash out and this is also due to late payment interest now being applicable to those tax payments.

Upstream

2. Offshore Law and Neptun Deep

Question from Oleg Galbur (Raiffeisen Centrobank): The question which probably was asked often recently relates to the recently approved law on the offshore operations. We all know that the framework which is being proposed by the new law is actually worse than expected and you made a few comments.

I would like to go into more details and maybe you could put more color on what is the company's view on the currently proposed framework, whether it is still good enough in order to take the final investment decision on the Neptun Deep project, or what would be the key points which need to be discussed with the government, and hopefully improved, in order to take the final investment decision on Neptun.

Answer Christina Verchere (CEO): I think there are a couple of points with regard to Neptun. I think what we do see is that the Black Sea is a huge opportunity for Romania and we see a lot of focus and attention on wanting to drive it forward for development.



The Offshore Law did put in a necessary framework from a regulatory perspective for offshore projects, but we did see some backward steps with regards to it as well; two particular areas would be a change: the increase of the government take and no stability around the supplementary tax.

We are looking to get clarity and we understand the government has said that there will be further clarifications made, to address both stability as well as investment deductibility, and we look forward to that clarification from the government.

Question from Tamas Pletser (Erste Bank): I have a question on the Offshore Law and the general regulatory environment in Romania. As I know, the onshore royalty law is still under discussion. Do you wait until you see the clarification for your major investment on this regulatory framework, or do you see this independent to the Neptun investment?

Also, do you see any chances to sign a similar agreement, like Petrom did back in 2004, for a kind of fiscal stability or you do not see a chance to sign such an agreement?

Answer from Christina Verchere: With regards to the Offshore Law, we do need to understand the position on the Offshore Law and get clarifications prior to an investment decision on Neptun.

With regards to fiscal stability, we do see that as one of the clarifications we are looking for. The fiscal stability was put around the royalty rate but was not put around the supplementary tax. In simple terms, we are looking for that fiscal stability to de-risk the regulatory environment that we have seen recently in order to be able to make a full investment decision.

Question from Tamas Pletser: I was just thinking here that when OMV acquired Petrom back in 2004, they signed a 10-year pact with the Romanian government at that time. Do you see a chance to sign a similar agreement with the Romanian authorities and the politicians or is it somehow out of the question?

Answer from Christina Verchere: Whether it is in those specific terms or in that specific format, I think that would be premature to say but we are looking to have fiscal stability. That has been a key factor how that materializes, it might not be in that same format that you are talking about, but the fundamental principle (of stability) is what we are looking for.

Question from Yuriy Kukhtanych: Does Petrom actually have some kind of committee which is participating in negotiations with the government and if it does, when is the next deadline or some kind of major date we should expect for any sort of decision regarding the new fiscal regime?

Answer from Christina Verchere: There is an industry association that is focused towards the offshore part of business here in Romania called RBSTA and it is through RBSTA that Petrom, along with other titleholders in the Black Sea, have dialogue and provide consultations with the government on that.

With regards to timing, right now the law has been sent to President for promulgation. I think there are potentially two scenarios. You could see something happen over the summer, to provide some form of clarification, or the Offshore Law could be sent back to Parliament and Parliament would re-look at it in the September timeframe.

We are waiting to understand that. In the end, obviously this process belongs to the State and these dialogues are important to occur. We are looking for a timely re-examination, whichever way it happens, we are keen to see if we can have a decision this year, but we do need this piece of information to make sure that we have a viable project.

Question from Yuriy Kukhtanych: I understand that Exxon and Lukoil are part of that association as well.

Answer from Christina Verchere: Yes.

3. Production decline

Question from Oleg Galbur: How should we look at this 4% decline rate that we expect for this year? Is that a rather realistic scenario or a more conservative one?

Answer from Stefan Waldner: You have seen a production decline of around 5% in the first six months. We do keep the guidance of 4%, because we do see additional production coming onstream in the second half of this

year based on successful drilling earlier this year. And we do believe that we will be able to keep the 4% decline year over year, of course excluding any optimization initiatives or sales of upstream assets.

Question from Tamas Pletser: Regarding this decline rate: what do you expect of the oil and gas split, do you expect still the gas production to decline faster than the oil production or this 4% which you predict, is it split evenly between oil and gas?

Answer from Christina Verchere: With the decline rates of production, we do see a different decline rate for gas than for oil. Oil is around 3%. Gas is actually higher, at 6% to 9%, in part driven by Totea, which has been a very successful gas development that came onstream in 2012, has now come off plateau and started to decline. So, actually, we see gas declining faster than oil at this point in time.

4. Exploration expenditure vs. production decline

Question from Oleg Galbur: I noticed that the exploration expenditures have increased significantly in the second quarter on a year on year comparison. I am just trying to understand if this intensification of exploration drilling is driven by a more favorable oil and gas price environment, and if we could expect positive impact on the future production decline rate, since you are still guiding for a 4% decline rate this year, but that would not include the possible improvements as a result of workovers and other exploration activities.

Answer from Stefan Waldner: Yes, indeed, exploration expenditures increased in the second quarter. This really reflects also our strategy of increased drilling activity. We ramped up drilling in the second half of last year and that continues in 2018.

Also, I would like to highlight that we have increased our working interest in some of the exploration licenses that we have, and also there is ongoing exploration activity both onshore and offshore this year, which has led to that increase in exploration expenditures. We are also guiding overall for the year to have an increased exploration expenditure compared to 2017.

5. OPEX

Question from Oleg Galbur: On the OPEX/boe, could you please remind us which part of the domestic production costs are USD denominated, so that we can make a better projection going forward based on the expected FX development.

Answer from Stefan Waldner: About half of our OPEX is related to salary costs which are typically in RON, and most of the remainder would be US dollar.

Downstream Oil

6. Petrobrazil turnaround

Question from Yuriy Kukhtanych: Impact from Petrobrazil. You mentioned RON 150 million impact versus RON 260 million of unrealized revenues. What is the difference and where is the difference coming from and how is it explainable?

Answer from Stefan Waldner: As regards the Petrobrazil impact, there is a RON 150 million impact coming from maintenance expenses as well as lost margins during the 45 days shut down of the refinery. The RON 260 million is slightly different, it refers to the fact that during the turnaround, the crude oil that we produced went into stocks because we could not process it in the refinery. And the Upstream profit related to those crude volumes that went into stocks are obviously not realized yet and therefore we have to eliminate that and that is shown in the consolidation line.

The RON 260 million is a temporary effect because now that the refinery is up and running again, we will process those excess crude from the inventory and this temporary effect will be reversed over the course of the second half of 2018.

Oleg Galbur: The last question is not a question but rather a request, again, from the market participants. I guess I have voiced it in the past but still, would you please consider splitting the Downstream Oil earnings by refining and retail, because that would make our life much easier and actually would improve probably the quality of projection and estimates going forward by having a better idea of what comes from retail and what comes from refining.

Downstream Gas

7. Forward electricity contracts

Iuliana Ciopraga (Danske Bank): Could you provide some details on the electricity forward context?

Answer from Stefan Waldner: We typically sell part of our power generation forward. We had a positive realized effect out of those contracts in the first half of this year of around RON 23 million. But what we also show, and that is the negative effect that you have seen in the result, is a mark to market valuation of the open position of those contracts.

Thus, there are two topics, one is the realized part and the unrealized part of the open position.

Question from Iuliana Ciopraga: Could you describe the volume, the price maybe and the period for these contracts?

Answer from Stefan Waldner: No. We typically cannot disclose those details.

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