

OMV Petrom Q1 2019 Conference Call – Q&A Transcript

OMV Petrom published its results for January – March 2019 on May 3, 2019. The investor and analyst conference call was broadcast as a live audio-webcast at 3:30 pm local time. Below is the transcript of the question and answer session, by topic, edited for readability.

Group

1. Neptun Deep

Question from Tamas Pletser (Erste Bank): Regarding your negotiations or discussions with the Romanian legislators and authorities, what is the current status? Can we expect any milestones with these negotiations? Anything which we should follow?

Answer from Christina Verchere (CEO): With regard to Neptun, we remain in dialogue with the Romanian authorities and I think if I just stand back, I would say this is a hugely important project for OMV Petrom and also for Romania. So I think there is a strong will on all sides to find a solution.

This is a discovered and appraised resource. It is, like most big gas projects, a jigsaw puzzle that needs to come together and it is important that we get the right regulatory framework in place so that we can get the full potential of the value of the asset. And therefore, it is prudent for us to make sure that this is in place and I think some aspects of the regulatory volatility have just reminded us why this is very important to do.

With regard to milestones: at this point, the dialogues are under way and when we are able to communicate something, be assured that we will. But it is, and remains, a key focus and priority for us.

2. IFRS 16

Oleg Galbur (Raiffeisen): Could you tell us what is the estimated impact of IFRS 16 on the full year 2019 operating results and free cash flow?

Answer from Alina Popa (CFO): The impact of IFRS 16 for OMV Petrom Group is not significant. With regard to balance sheet first, we are referring to approximately 300 million RON increase of assets and increase of liabilities. When it comes to the impact on the net income line, there is no impact; it is just a reclassification from operating to financing and from rent to depreciation.

If you want a bit of indication, the depreciation will be higher with approximately 15 million RON now, so it will be really not a big amount. When it comes to cash flow, there is no impact on cash flow from net cash flow line; it is just a presentation change because rent payments, which were previously shown in operating cash flows are shown now in financing cash flow. Here we are referring to about 10 million RON, not major footprint on group I would say.

Upstream

1. Production decline

Question from Tamas Pletser: you mentioned at the end of this and previous presentations as well, that you expect a 5% decline in the production without portfolio optimisation. So based on this I estimated around 150,000 barrels a day production for this year, what do you think? Is this guidance realistic or do you expect any further portfolio optimisation?

Answer from Christina Verchere: In the first quarter, what we saw was a decline of 5.3%; we maintain our full year production estimate of 5% decline. There are two points I would emphasize as to why this is. One, we plan to drill more than 100 wells this year; 21 of which we have drilled already. And the second aspect is Kazakhstan and the ramp up of workover activity that started at the beginning of this year following a pause in 2018. These are the two aspects that give us confidence for the 5% that we have in the full year outlook.

Question from Oleg Galbur: Regarding your production guidance for this year: If you could tell us what is the current level of production of wells that are planned to be divested this year?

Answer from Christina Verchere: On your production question, just to clarify that the nine fields that we have divested in this last package make up for about 1,000 barrels a day of production. In total, the 50 – 60 that we are looking to divest represent about 2,500 barrels a day. Again, these are marginal fields, which allow us to optimise our operational footprint, focus on where the big value generation is. And I think this is a normal practice to see. The other effect of the divestment, which I think not everybody necessarily acknowledges, is that it brings a few more producers and operators into Romania, and I think overall that is good for Romania in general.

Downstream Gas

1. BRUA, other gas infrastructure projects and EGO 19/2019

Question from Tamas Pletser: Do you see any urgency on the side of the politicians? I mean as I follow the events now, building the pipeline is also under question. So I suppose it should go parallel with your project. I mean do you see that politicians realise that the whole thing can go bust?

Answer from Christina Verchere: I do not want to talk on behalf of the other side, but what I do see is a will to find a solution for Romania. Romania, particularly in the winter seasons, is a net importer of gas and I think we all see that the opportunity to develop this resource actually will underpin security of supply for Romania, and also will turn it into a key energy player in the region. I think this is understood by all sides. So what I see at the moment is that people are at the table and willing to have the dialogue. That would be my representation of people wanting, all sides wanting to move it forward.

The other aspect I would point out is that we did see a move back towards a liberalised market with the Emergency Order no. 19. I think it is fair to say we all had a busy Christmas period after GEO 114/2018 came out, not unique to the energy sector. We saw increased dialogue after that in the first quarter of 2019 and we saw a return of 60% of the market to being fully liberalised. I think this is an important factor for us as an investor, not just in the Black Sea, but for all investment aspects. So again, I think that is an indication of willingness to try and make sure we can find a solution to ensure energy supply in Romania and beyond.

Question from Yuriy Kukhtanych (Deutsche Bank): I have a question about the gas infrastructure in the region; if you could just update us on ongoing projects. How is the BRUA pipeline going? Especially in the context that the Ukrainian route may be closed in a very short period of time, or the gas supplies to Romania. What role OMV Petrom has to play in this context and is Romania booking any volumes in the new Turkstream pipeline for the domestic market at all? And again if you could just provide any updates it would be very useful.

Answer from Christina Verchere: Energy security and energy supply we see as two fundamental aspects. Obviously, indigenous production is the foundation of that, but multiple access routes represent a key point too. I think it is also fair to say that Romania is on the cusp of moving from a net importer to the potential to be a net exporter. But actually export routes are key, as well as import routes that fundamentally underpin security of supply, and this is a dialogue that we continue to have with the state. And we see that Transgaz has a pretty extensive plan to work on all of these routes.

You talked particularly about BRUA; I would probably just add two comments to that. One that the current 1.75 bcm of capacity is under construction and believed to be on track and we get regular photos and updates actually from Transgaz on the progress. And in the past we may have thought construction of infrastructure to be a constraint or a risk, so there is actually confidence being built in Transgaz and their ability to deliver on that.

With regard to BRUA Phase II, or the capacity expansion to 4.4 bcm, I think the timeline is being managed by the TSO. There was an extension of the timeline; any further extension will be a decision by the TSO.

With regard to your question on Turkstream, we do not comment on any aspects, including on whether or not we would be looking to bid with regards to access and capacity.

2. Gas sales and gas price cap

Question from Irina Railean (BT Capital): You have mentioned in your earnings report that you expect higher gas sales volumes, while at the same time the gas demand is rather seen to be flat. Where do you see the potential for these higher volumes coming from? And how do you plan to supply these volumes given that the production is seen to decline?

Answer from Alina Popa: The newly enforced regulations for gas producers to supply the regulated market will cause a reduction in OMV Petrom's equity gas volumes available for its regular customers. So we already have the obligation to supply the regulated market with approximately 12.5 TWh for the period May to December 2019.

In addition, we need to fulfil our contracts and to maintain our customer base and we will operate our power plant, so consequently we anticipate that we will buy gas from the market and therefore our gas sales volume will be higher than previously.

3. Brazi power plant and obligation to sell electricity for the regulated market

Question from Irina Railean: Given that the gas price is capped only for households, may we expect a change in the 260 RON per MWh regulated price for electricity and how the authorities will establish the regulated quantities for 2020 for electricity producers? I mean is there any methodology, any rules for these volumes?

Answer from Alina Popa: Relating to the gas price cap and electricity price; currently the regulation from the ANRE basically gives the guidance of a cost plus 5% margin and that was calculated for us, reaching the value of 260 RON per megawatt hour. According to the methodology of this regulation, this calculation will be updated in the future. So we expect, depending on how the cost will be, that we will have an update here coming from the regulator.

Question from Irina Railean: Do you have any figures from how much of the gas input to Brazi power plant will come from equity gas and how much from market gas or imported gas? Can you provide such details?

Answer from Alina Popa: Unfortunately, we cannot provide details. There are a lot of discussions with the regulators to clarify secondary legislation with regards to the ordinance 114/2018 and ordinance 19/2019, so we are still analysing ourselves. We cannot provide at this stage any further information.

Question from Irina Railean: For the allocation of gas quantities, ANRE has a methodology, which is established like of pro rata rate based on production. But how will the regulator establish the electricity volumes? For instance for 2020, how will the regulator establish how much OMV Petrom should sell on the regulated electricity market?

Answer from Alina Popa: We have received the gas quantities allocated until the end of March 2020. We have approximately 40% of the market at a regulated price. This is the information that we have right now and you can use for your estimated quantities. What we know is we have received for electricity a volume of 1.14 TWh for the period March to December 2019; so this is the volume, which is quite high for Brazi. We do not have information related to future regulated volumes allocated to us.

Downstream Oil

1. Operating results

Question from Oleg Galbur: I am a bit puzzled by the strong performance of the Downstream Oil segment because, despite a 45% weakening of your refining margins, the segment's operating result declined by 9% only, so maybe you can help us understand what was behind this strong performance in the first quarter?

Answer from Christina Verchere: With regards to your Downstream comment; thank you for noticing that. It was a very strong quarter for Downstream Oil and I would say it was predominantly driven by the refined products sales as well as the retail sales, which were both up; 5% for total product sales and 6% for retail sales volumes. But what we can see is that we grew at a slightly higher pace compared to the market, which we think

is down to some of the promotional work and marketing efforts that we are doing, particularly on the non-retail side. So overall, we had a strong quarter on the sales side and also regarding the operating performance of the refinery itself.

2. Retail market growth

Question from Alex Burgansky (Renaissance Capital): Could you comment on the base of the retail market growth in Romania? You said that it was up about 6% in the first quarter, so I was wondering whether you have any comments as to why the growth appears to be so strong and what is your expectation for the rest of 2019?

Answer from Christina Verchere: I think that there are two aspects going on: one is the overall market and then part of it is our performance within the market. With regards to the overall market, in general we saw a warmer first quarter than we had seen in the first quarter of 2018, so people were out more as a result of that, and a slightly stronger economy with regard to income levels. And then, we continue to see the effect of the high number of imported cars coming into Romania in 2017 and 2018, that are sort of driving the market. With respect to our performance within the market, our ability to disproportionately capture that market I already mentioned in the prior answer. So there are two factors coming in there, both of which we think are what drives the performance.

Regarding the rest of the year, I think we continue to see a growth maybe at around 3% and we would stay confident in our ability to disproportionately capture that but I think we need to let performance speak for itself at that point in time.

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