

OMV Petrom Q2 2019 Conference Call – Q&A Transcript

OMV Petrom published its results for Q2 and January – June 2019 on July 31, 2019. 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. Neptun Deep

Question from Oleg Galbur (Raiffeisen Centrobank): As we all know, there are some rumours on the market and, provided that Exxon is ready to dilute and wants to divest his participation in Neptun, would Petrom be interested in increasing its ownership in Neptune?

Answer from Christina Verchere (CEO): With regards to your question about Exxon, we won't provide any comment with regards to what's been put into the media on that. But I would comment with regards to Neptun, in general. It is appraised and discovered resource and it is technically ready. It is waiting on the right fiscal and stability and competitive environment to be clear and after that, we want to be able to see line of sight to a robust project.

So at this point in time, I think we have to wait and see if we can get the right terms in place to be able to move the project forward to some degree, regardless of equity in that.

But maybe I'll take the opportunity to add a couple of comments on where I think we are with regards to those discussions. We have open dialogue with the authorities and I think it's fair to say to some degree the dynamic that we've seen in the second quarter in the gas market and increased imports coming in because of reducing gas production helps to emphasize the issue of what really Neptun can mean for Romania in terms of underpinning energy security for the country. And with that, I think that helps to emphasize the dialogue with the authorities as to how important this project is. So we continue to be in dialogue on that.

I think the other factor that needs to be in place is how we walk back to a liberalized gas market on that. And, just as a reminder, Emergency Ordinance 114 came in at the end of last year and fully regulated the market. And then, in April of 2019 Ordinance 119 came into place, put 60% of that market back free and 40% is currently regulated as a fixed price of 68 RON/MWh. Through the associations, we are in dialogue with the Romanian authorities as to what the next steps are to be able to come back to a fully liberalized market.

Two areas of focus. One is about how to put a mechanism in place for vulnerable customers. This does not exist at this point in time in Romania, and yet does exist in many other European countries. And if you've got rising energy prices, then you can see drastic measures being made. So if we can get this mechanism in place, that we see as a key aspect to remove the gas price cap.

The other thing that we will be advocating for is a release mechanism to replace the central market obligation, because we think that actually is not functioning as maybe it was designed to, and there are other release mechanisms that exist in other European countries that will be better. So those are the two areas of advocacy that we are doing fundamentally in service of improving the investment climate in Romania and being able to progress Neptun forward.

Upstream

1. Oil Royalties

Question from Iuliana Ciopraga (Danske Bank): Regarding the royalties for oil, do you see an impact from this change in taxation at the moment?

Answer from Alina Popa (CFO): On royalties, we had a change in the regulation for reference price, which came in in May this year. So as you know, royalties are paid based on the higher between realized price and the reference price. The change in regulation has linked the reference price for oil to Brent with some quality adjustment on sulfur content, acidity and density. The impact of the change in regulation, if we would apply it for 2018 royalty calculations, is approximately 4% increase.

Downstream Gas

1. Gas and electricity market

Question from Tamas Pletser (Erste Bank): I got a question regarding the electricity and the natural gas market. Can you tell us what has happened during the second quarter on these two markets in Romania? And what have you seen during July? I am especially interested in how these collapsing European gas prices affected the Romanian gas market. Is there any risk that the import would flood the market, because, as I see now, the current Romanian market prices are well above the European prices.

Answer from Alina Popa: Electricity and gas markets in Romania are significantly affected by the regulatory changes, which we had at the beginning of the year. We started to have a regulated market for gas in May, so we have quantities to be sold on regulated markets. On the other hand, this, corroborated with a decline in our own production – we had a decline in gas production of around 8%, and an increase of storage obligation – this created the need to import gas. So we had higher imports of gas at the Romania level. There is no official information for the entire period; official data is published only until April, but in the first quarter, imports are already higher by 11% in comparison with the last year. April was the very height of imports, around 1.3 terawatt. We have no data for May - June, but we see that being as well higher than the previous year.

So what we expect in the next period: of course it depends a lot on how the regulatory will affect the gas market. So there are discussions going on, but nothing concrete yet, or nothing in public consultation at this stage. But the fact that the domestic production is going down, is a fact and this needs to be compensated somehow, it can only be import.

I wanted to say a little bit about power, as well, because you also talked about electricity. So Q2 in electricity was influenced by the fact that hydro was doing very well. It was a lot of rain in Romania in Q2. So from Petrom perspective, our power plant was closed most of the time, we also had a plant shutdown. But even for the period when the power plant was working from an operational perspective, it was not economic to run it due to the fact that the gas prices were high and also CO2 prices were very high.

Question from Tamas Pletser: What I see from the regulation and the current prices, the current environment is quite positive to you, because now you can import at a significantly lower cost and you can sell this gas at a fixed price, at RON 68 per megawatt hour for the households, at least. So somehow, these current market changes are quite favourable to you. Am I correct with these assumptions?

Answer from Alina Popa: I mean the part that we sell on the regulated market, at 68 RON/MWh, that is approximately 50% of our production. We sell at 68 RON/MWh, which I would not say is favourable. What is happening actually is that the free market is not really functioning well. So due to this central market obligation, which puts a lot of pressure and also in combination with the decline of production, the prices on the free market, on the remaining market are quite high.

Question from Oleg Galbur: The second question would relate to the gas prices. So this is a follow-up on what has been just discussed. Taking into consideration that you have to sell a certain percentage of your production at domestically regulated prices, and the reasoning for import prices and this import comes mainly from the east – would it be correct to assume that the non-regulated prices in Romania are now even stronger correlated with the Russian oil linked prices, rather than hub prices?

Answer from Alina Popa: The gas prices on the free market tend to be more correlated to the Russian prices as there is a lot of import needed for Romania, which is influencing that.

Question from Irina Railean (Banca Transilvania): I would like to know what is the impact of the gas price capping in the second quarter or how much of a decline in profitability for the Downstream Gas is due to gas price capping?

Answer from Alina Popa: With regards to gas price, first of all we cannot publish the realized price, due to the competition restriction, but I can give a little bit of guidance. Our realised price is a combination of the regulated gas price for approximately 50% of our production and the rest on the free market is to a good extent reflecting the market price. This you can take as a realised price and then making the difference to gas price cap, you can do the calculation of how much it would be. Of course, the major question, which is hard to answer, is if this gas price cap would not have been required, what would have been the gas price? Yes, that is a question we cannot answer, but we can speculate around it; but if you do, if you want to do just an economic estimation, you can do it that way.

Question from Irina Railean: And this 105 RON/MWh, is this an average weighted for both segments, for both regulated and competitive, or this is only for the competitive market?

Answer from Alina Popa (CFO): That is just a market price, it is not our price. It is a combination between BRM and OPCOM.

Question from Oleg Chistyukhin (Renaissance Capital): From the 1st of May you are also obliged to pay this 2% on the turnover of the gas. So could you please tell us the total value that you have paid for the second quarter? And also I would like to ask, could you please repeat the share of your sales on the regulated market. This would be for the 68 RON/MWh price.

Answer from Alina Popa: Indeed, starting 1st of May, we are paying these 2% on the turnover, it is on the turnover of both gas and power. We paid RON 13 million for gas activities and RON 4 million for power activities for Q2. If we look at the six months, because we started the payments with Ordinance 114 modified by Ordinance 19, we paid RON 26 million for gas and RON 15 million for power. Basically, the invoices are done on the estimated turnover of last year, so this is how the payments are done. We receive invoices from the regulator, ANRE. And then we will have some adjustments to be done based on actual sales at the end of the year.

With regards to the regulated market. If I understood you correctly, the gas which we sell on the regulated market out of domestic production is approximately 50%. If we refer to the total regulated market, it is approximately 40% of the total gas market of Romania.

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

Question from Irina Railean: Could you provide the electricity volumes sold on the regulated market since March?

Answer from Alina Popa: With regards to the power quantity sold at regulated prices, we had in Q1 58.54 gigawatts, in Q2 127 gigawatts, so in total we had 185 gigawatts for six months.

Downstream Oil

1. Operating results

Question from Oleg Galbur: My question relates to the Downstream Oil business and more specifically to retail and wholesale business, which was doing very well in the second quarter. Could you please tell us if this performance of retail and wholesale was mainly driven by favourable macro-picture in the region and domestically, namely increasing consumption of motor fuels, or rather by a one-time event such as contamination of Russian Crude supplied by a Drujba pipeline or refinery shutdowns in the region or other developments?

And could you say a bit more about this 52% increase of non-retail sales volume which, as you mentioned in your report, was driven by opportunistic initiatives, as well as how is the market environment looking in the third quarter? Is it still supportive or there are some changes?

Answer from Alina Popa: We would see the increase in the retail coming mainly from three dimensions. First one, we had the very good weather conditions and some holiday leading to increased traffic. On the other hand, we had the good development of the economic environment where private consumption increased, also the development of agriculture. And the third one would be coming from the large number of imported cars in Romania, which continued in 2019 and is supporting the increase in demand.

Now, with regards to if we see this continuing in the third quarter: Yes, the third quarter is always for us a good quarter. So we do see that this continues for retail; for non-retail, the main reason were shutdowns of the refineries in the region. So there were temporary turnarounds, but also we should consider the fact that we had Petrobrazi turnaround in 2018.

2. Refining

Question from Iuliana Ciopraga: Do you need import for your refinery and if you do, does it impact your margin?

Answer from Alina Popa: Yes, we do use imported oil for our Petrobrazi refinery. So approximately 15%, I would give as a guidance. Basically on margin, to give you a little bit of guidance: even our domestic crude is on an arm's length basis. I would not see a big increase on margins starting from that.

3. Retail

Question from Iuliana Ciopraga: There have been some comments in the media that Auchan is looking to take over the shops in the filling stations. Is it true, can you confirm the impact on that?

Answer from Alina Popa: We are in discussion with Auchan for a partnership, we had a pilot in the past. The press was a bit misleading, because they were talking about a takeover by Auchan. We are in discussion to find a partnership for our Petrom retail network and we expect that we will be in a position to conclude the discussions and come back with the news by the end of the year.

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