

OMV Q3 2018 Conference Call – Q&A Transcript

OMV published its results for January–September and Q3 2018 on October 31, 2018. The investor and analyst conference call was broadcast as a live audio- webcast at 11:30 am CET. Below is the transcript of the question and answer session, by topic, edited for readability.

OMV Group

M&A

Question by **Robert Pulleyn – Morgan Stanley**:

Could you maybe update us on the M&A strategy in the pipeline? Obviously, you had lots of announcements, but if the Achimov deal closes in cash, there'll be a little bit less available for further upstream. Having said that, the balance sheet is in very good shape. So how do you think about the M&A pipeline from here?

Answer by **Rainer Seele**:

Well, we will continue to be very active. That's what you all like, isn't it? You would like to have positive surprises with good deals. If there are good deals available in the market, OMV will look at it. The financial strength of OMV gives us the flexibility to look into the M&A possibilities. We will be in full compliance and deliver on our promises we have done to the financial market. If I look into 2019, I confirm, I reconfirm that we are targeting and that we are managing the company and our balance sheet that we would like to be free cash flow breakeven or positive after acquisition and after dividends and whatever we have to pay. So that's a valid target we have in our company. When we talk about, down the road, the M&A strategy, I agree with you, Rob, that the window of opportunity is more and more closing in the Upstream sector, because the higher oil price is flowing also into the expectations in the M&A market and maybe the price tag for Upstream deals is going to be too high. If I look, what I can see in my cloud of M&A activities, I have problems to find, really, Upstream project, yes? Secondly, we have said also in our Capital Markets Day in March, we will focus on more Downstream asset as we also have budgeted some M&A money for Downstream acquisition. Maybe the window of opportunity in the Downstream sector might open, we don't know. So a clear answer to your question, yes, we will continue next year with Sapura, with Malaysia and with Achimov IV/V. If there is anything down the road, it has to be a very good summer sale price tag on it that we will look into it.

M&A – Achimov 4A/5A

Question by **Yuriy Kukhtanych – Deutsche Bank**:

I have a couple of questions around Achimov deal. First of all, if you could comment, what are the conditions or preconditions to close the deal? Because I understand it is still conditional. And whether it is dependent on the Nord Stream 2 construction progress or legal status, or there is anything else on that side? And second question is how are you going to fund the deal and the ongoing CAPEX before production starts at the field?

Answer by **Rainer Seele**:

Thanks, Yuriy. The preconditions to close Achimov deal is, first of all, we have to agree on the purchase price with Gazprom. That's one condition. Of course, if we can't find each other in the right number, we will not discuss any closing of the deal. But I'm very positive that we are going to find each other. Second, the deal is then, of course, depending on the approval of the Russian authorities, which is a normal procedure given the fact that OMV was qualified also as partner in Yuzhno Russkoye. I don't see any concerns, but you never know. And third point, the transaction is not depending on Nord Stream 2, not in any case. It is a separate transaction with Gazprom and there is no combination of whatsoever. So it's a clear path, the transaction of Achimov IV/V. How are we going to fund? Let's first become partner and with full reliability, then we will sit together and discuss with Gazprom and BASF how we are going to fund the investments into the field development. One thing is quite clear, we are, of course, clearing in one step the path for the investments done so far by acquiring the share.

M&A – Sapura Upstream

Question by **Jason Gammel – Jefferies**:

I appreciate this maybe too early to be asking this, related to Sapura. Can you talk about the governance of the Sapura Upstream organization once a deal is completed? I'm really thinking specifically how much influence will you have over the operatorship of that entity? And would you anticipate any OMV secondees into the organization?

Answer by **Rainer Seele**:

Jason, in terms of Sapura, of course, I can't give you any information concerning the corporate governance because this is under negotiation and we will publish all the data the day we are going to sign the final agreement. But let me take your question a little bit

more in a philosophic way to explain it to you. Of course, we would like to gain some certain influence, but the way we have made an announcement of the partnership with Sapura is that we would like to be equal partners. We will run the company as a 50-50 joint venture. This is what we have agreed. This is what we have on the table when we are discussing what is going to be the corporate governance and how we would like to steer the company. So we will do that together. And I have a preference, in my experience, all the partnerships I have seen, it doesn't matter whether you talk about the partner in Russia, the partner in the Middle East and our partner in Asia, it always works well when none of us is dominating the show. That's the reason why we also have approached our partner in Malaysia that we would like to become equal partners. Let's wait how the negotiations will be finalized, but that's more the intention both partners are ready to discuss.

Question by **Thomas Adolff – Crédit Suisse**:

I want to wish you good luck with the 50-50 partnership in Malaysia. I think it often ends in tears, especially in that part of the world. I mean TNK-BP was a mess towards the end, Bumi was also tricky. And I remember very well a president saying 50-50 never works, so not really sure I followed your earlier comment.

Answer by **Rainer Seele**:

All right. Thank you, Thomas, that you're pressing your thumbs for OMV that we will have a good 50-50 partnership. What I can say is the track record of our company is good, yes? That others cannot do as good as OMV, convinced me that we should prove that we also can do it in Malaysia.

Question by **Bertrand Hodee – Kepler Cheuvreux**:

Relating to Sapura Upstream. Would you, do you want this JV to be consolidated or equity accounted? So what would be your preferred solution? I know everything is not closed yet, but in a blue sky scenario, would you prefer to have Sapura Energy, 50% consolidated or equity accounted?

Answer by **Rainer Seele**:

Bertrand, this is a real clever question, yes? Absolutely clever question. And you will get, of course, a straightforward answer. We are striving forward to fully consolidate Sapura business, Sapura Upstream business. But we will decide on the day we are going to have all the negotiations, but we would like to show the figures in our operative number. So let's wait and see.

M&A – Downstream

Question by **Thomas Adolff – Crédit Suisse**:

On Downstream M&A, if I remember correctly, half of the EUR 10 billion is reserved for Downstream. And I wonder whether that half is defined as upfront spending, i.e., acquisition spending or rather associated development CAPEX. Because in essence, if you're bidding for a new development, you don't pay for anything that doesn't exist, but it is the CAPEX that's associated with the development.

Answer by **Rainer Seele**:

Concerning M&A transactions in Downstream, this is an acquisition budget. It's not a development project. So the budget for Downstream asset is a budget for the purchase price or the acquisition price we have.

Hedging

Question by **Michele Della Vigna– Goldman Sachs**:

About hedging. We've seen the benefit this quarter of a lower amount of hedging versus the first half of the year. I was wondering how much you still have left for 2019?

Answer by **Rainer Seele**:

First of all, we can reconfirm that there is no oil hedging for 2019. And the OMV board is not discussing any oil hedging at the moment for 2019. Honestly speaking, Michele, we are going to have more discussion in our board until year end, what is going to be really our hedging strategy. Some of you, when I was listening to you, are making me think, yes? Because I think your arguments are really weighting higher that we do have now worked hard on our portfolio to create an internal hedge in our portfolio. This is the integrated substance we have. And looking into that, we might benefit in Upstream when the oil price is high and we might benefit in Downstream when the margin is high and the oil price is low. So therefore, I think, I can confirm that our hedging appetite is extremely low. We have said this also in our last conference call, the hedging activity for the fourth quarter, the guidance is quite clear. It's the same hedging level we have had in the third quarter. As we speak about our hedging or hedges we have underway in 2019, we will wait until the year end to give you, and beginning of 2019, an answer on your question. All I can say is, right now, we have no hedges in place for oil. The hedges for gas, I will explain to you beginning next year. One more information on our gas hedges, yes? We have one gas hedge in place I would like to explain to you a little bit further, because this is a hedge we will continue to have. This is hedging of our gas margins from gas supplies where we have to change the pricing formula. This is in the LNG business, and I'll give you one example. For example, we have under contract, LNG supplies from the U.S. which are indexed to Henry Hub and to convert it into TTF price. At a certain point of time, we are locking in the margin. If the gas prices then will go up, then, of course, we are missing the backwinds in the prices and then we have these hedges in place. But we are going to hedge the gas margin the day we are going to sign the contractual terms and the margin is positive. Then we might miss a little bit the upside potential, but this is the kind of hedging we will continue also in 2019.

Tax rate

Question by **Michael Alsford – Citigroup**:

On tax rate. Thanks for the guidance on 4Q, but I guess as we look into 2019 and with the higher tax barrels in Norway and Abu Dhabi ramping up, could you give us some indication on where you see the tax for the company for say flat oil prices?

Answer by **Reinhard Florey**:

Michael, regarding tax rate, you have seen, as we had promised last quarter, tax rate has come down to a level of 38% in quarter 3 for the clean tax rate. We have now seen that, of course, also in the second half of this year, the prices have been clearly rising above the levels that we have expected, so when we gave the guidance for full-year tax rate around mid-30s at the oil price of \$70, we are now saying that it will be in the high 30s, given the current commodity prices for the year 2018. For the year 2019, we have not given yet a clear indication, but you mentioned already major factors. I think it's important to see that, of course, the share of our production in higher tax countries is increasing and that also the situation in Norway for some of our tax loss carried forward will ease out, will lead to a situation that will have, in general, higher taxes there.

Question by **Michele Della Vigna – Goldman Sachs**:

On your tax rate, you're guiding to the high 30s. Is that also the assumption we should be make in the coming years if we stay around \$70 in terms of oil price?

Answer by **Reinhard Florey**:

I think it is important to see that the tax rate as such always has the context with the level of oil and gas prices. Of course, if you have higher prices, then also your tax rate will be higher. We are currently not in an environment of USD 70/bbl. So, therefore, my guidance for the high 30s was also not on the level of the USD 70/bbl but for what we have guided for the rest of the year. And for the way forward, I already told you that there are some impacts that, in general, will have a tax rate rather rise than decrease in our case with the change of portfolio that we have in mind.

Upstream

Production guidance

Question by **Peter Low – Redburn**:

On Upstream production more generally. You talked about exit rate of 500,000 barrels per day, is that then sustainable at that level through 2019 or kind of given normal maintenance and fuel downtime, should we expect the 2019 average production figure to be below that level?

Answer by **Rainer Seele**:

It is sustainable. So if we run into 2019, the active production of 500,000 has more an upside than a downside. Why? We are expecting that we are going to finalize our negotiations with Sapura Energy until year-end and then closing will be in 2019 so that an upside production from Malaysia is running into our average production figures. The rest in our production level in 2019 is more coming from other region. The question in 2019 is how is the stability in Yemen and Libya? And if there is a deviation in the downside, it is the production level we have in these two countries, given the fact that we have there some geopolitical instability.

Question by **Giacomo Romeo – Macquarie**:

My first question is on Yemen. And, another small progress there in terms of production. Just want to have an update from you on what's the status of your operation in the country and what sort of outlook you might have. And similarly, for Libya, we are seeing some pretty strong loading data for the country in September, October. Can you share, perhaps your view on how things are progressing on the ground there? Second question is with regards to your production in Austria. You had a very steep decline this quarter. Just wondering if there's anything there that other than natural decline that we should think of?

Answer by **Rainer Seele**:

In Yemen, we do have a production level of more than 5,000 barrels per day. We have already loaded 2 cargoes. The cargoes are paid. And although we do see, of course, a difficult environment in Yemen, I would give you only the guidance. Let's take the number and continue until year-end. In Libya, we have said that we see, although the security situation has not improved in the country, we do see a stable production in Libya. We have above the 25,000 barrels per day in 2018. So I would say, in the fourth quarter, above the 25, more close to the 30s is the production level which I see in Libya. The country is, of course, looking for stability since quite a while. And if we Europeans are not supporting them in their efforts to stabilize the country, I think that, in the mid-to long term, that the situation in Libya will stay as I have described it. There is nothing else than the natural decline in Austria. There's no specific, if you continue to see their production with the natural decline, I think that's the basis how you judge it. If there is a new production knocking at the door, then we will let you know, but right now, it's only the natural decline.

OPEX

Question by **Jason Gammel – Jefferies**:

I wanted to, first, come to the excellent performance that you had on the operating expenses in the Upstream during the quarter. Quite a low level, certainly less than I thought. And I was hoping you could address, essentially, the sustainability of that level, just

assuming no oilfield service inflation, particularly given that some of the production that is coming into the portfolio would appear to be relatively low-cost.

Answer by **Reinhard Florey**:

Jason, regarding your first question, the operating expenses is in Upstream, you were asking about the sustainability of the level and I can give you a little bit of an insight of the development there. We had even an improvement of the development of the cost side that we had in Upstream from quarter two to quarter three. And that was mainly coming from our cost savings and cost improvements in Romania as well as in Norway. We also had some positive effects from Austria. We did not see a major impact yet from the good cost position that we have in Abu Dhabi there. So you can take it from there that bringing in more of the volumes from Abu Dhabi will even get us to a better position. So in terms of the sustainability, this is a clear yes.

Gas prices

Question by **Joshua Stone – Barclays**:

On the gas prices, you talked very positively and indicated gas prices going up, but your realized gas prices continue to fall and you did highlight some of the lag on production from Yuzhno in terms of price. So are there any other effects holding back your gas price realizations? It sounds like you have decent visibility of gas price realizations into the fourth quarter, so maybe, again, on that you might be able to give us some more guidance.

Answer by **Reinhard Florey**:

Compared to what we have seen as an increase in gas prices on the NCG level, the realized gas price increase has been quite moderate. This has actually two major reasons. The first is that, of course, we are not selling our gas always in NCG. And what we have seen is that in other regions, the increase of gas prices has been less pronounced than what we have seen in the NCG side. So if you take, for example, Romania or if you take New Zealand, these are different gas price developments and they have been on a lower increase than you have seen on the NCG. The second major reason, as Rainer has already referred to, that we are not benefiting in this quarter full from the increase that we would see also in the BAFA price on the international price that we have for our Russian gas. As Rainer said, this is a price formula that takes into account a two-month delay of price development, so, more or less, a little bit of a backward-looking pricing effect. So we're expecting that the price increase that we have seen specifically in the two last months of the third quarter will be positively seen also in fourth quarter and has not been fully reflected in the realized gas price in the third quarter as we showed it.

Question by **Thomas Adolff – Crédit Suisse**:

On European gas market, you talked about the lag effect, but I wondered whether there's a specific formula also. I mean, Equinor uses different types of benchmarks and then there's day-ahead, months-ahead, season-ahead and year-ahead. So I wondered whether you can help me a little bit with the formula that you use for the realization.

Answer by **Rainer Seele**:

The pricing formula we have is a published gas price at the German border. The so-called BAFA price. And the BAFA price is the basis of our price formula. But the way we have it, it's more a traditional gas pricing formula from the past, which we have in our contract and the BAFA price is then indexed with the time lag of 2 months. So if the price today is 100, let's say, 2 months later, you will see the 100 in our formula. That's the way how we do that.

Question by **Robert Pulleyn – Morgan Stanley**:

Could you talk a bit around to add color on the gas liberalization in Romania and how we should think about Romanian gas prices, which are a bit of a black box from where we sit in terms of shadowing the moves we're seeing in wider Europe.

Answer by **Reinhard Florey**:

Gas liberalization has taken clearly place in the gas industry already. So the industry is liberalized. Regarding the whole situation about the gas pricing, there is development that we, of course, carefully watch. There have been some messages from the government that went into positive direction. There have been some messages that make us watch very carefully also on that side, but we are not worried. We think Romania is a country for gas production. We are also seeing that with the prospects that Neptun project, which we are now carefully investigating after the offshore law, has the potential to be a gas exporting country and therefore, liberalization of the gas price market is also very important for us.

Question by **Robert Pulleyn – Morgan Stanley**:

Okay. If I may just follow up on that, please. I mean, in terms of given that development and your comment previously about Romania being a different market, should we now expect that Romanian gas prices will close the differential versus what you get in the rest of Europe? Or is that going to take some time?

Answer by **Reinhard Florey**:

This will not come from today to tomorrow. This is something that we are, as said, we are watching very carefully. But we have a very well established company with Petrom there, which we own to 51%, and therefore, this is a country where we think that it is worthwhile doing business.

Neptun

Question by **Peter Low – Redburn**:

Could you give us an idea of what the specific sticking points are preventing an FID and whether you're still confident those can actually be overcome in 2019?

Answer by **Rainer Seele**:

Talking about Neptun Deep, first of all, as I said, we have to look into the different wording. One of the points important for us when we are going to decision-making is fiscal stability coming with the offshore law. If I have a first look into the draft, what I have seen so far, I can see that upcoming. But we have to see the process in Romania. First of all, we have done now the first step and we hope that the second step is going to happen. And this is more determining the timing of our decision-making. I think we have, more or less, the framework we can discuss, but it will be up to the Petrom Management to make their final evaluation and their decision on whether or not they would like to bring that project forward to their shareholder OMV.

Question by **Matthew Lofting – JP Morgan**:

Just coming back to Neptun, but thinking about it more from the perspective of CAPEX outlook into 2019. I'd be interested to know how much budget or spent you'd allow for Neptun next year and to the extent that the FID continues to be delayed, what that could mean for the fiscal frame next year?

Answer by **Rainer Seele**:

It's more or less a difficult question you're asking me. First of all, I have to see the fiscal frame and I have to ask myself when the fiscal frame will be in place. Then I will tell you when the FID is. And then, of course, the investment, the CAPEX spending will start. So therefore, Matt, sorry that I can't give you a better answer on Neptun, but it's really depending on the timing of the approval process of the Romanian government and what kind of framework we will see. From my point of view, it should be a reliable, long-term, stable fiscal framework. If this is not coming, then we have a problem because we have to invest, and we have to produce over a cycle of decades. And that's why, I think, we have to wait and see. I just want to make one comment on Neptun because we have discussed the gas prices in Romania. I think Rob has asked that question. Rob, one thing is for sure, the Neptun gas we are producing is not exclusively for the Romanian market. So the gas price you have, you can use. To evaluate the value of the Neptun development should not be based on the Romanian gas prices. We will have a certain amount, from my point of view, the majority of the gas will move into the European gas market so that the majority of the gas we will produce will also find the European gas price.

Downstream

Margins

Question by **Joshua Stone – Barclays**:

Just on the Downstream, we've seen reports of very low water levels in the Rhine forcing some of your competitors to close down production. Can you talk about to what extent that benefited your chemical earnings in September? And also to what extent that can be seen supporting Downstream earnings in the fourth quarter?

Answer by **Rainer Seele**:

Josh, I have to say we like the low water level in the Rhine. We are benefiting from the situation that we have supply disruptions in some regions, especially in Southern Germany and definitely we are benefiting from it. We do see a shortage of diesel. We have, right now, a high liquidity of gasoline in the market. So I think it will continue for quite a while. I look always to the weather forecast. Looking outside the window, I have a view on the Danube River and the level is too high to be honest. So the situation down the Danube River has disappeared, but the Rhine River and the situation in Bavaria will stay. How long it will stay it's depending on, maybe, upcoming rain in the next weeks. So right now, we do have that positive impact, but we are also benefiting from a shortage of the supply, especially in southern Germany because of the refinery accident we have seen in Vohburg, so that the market there has a very good price level right now. So we will benefit from this also in the fourth quarter, positively in the Downstream business. But just to correct your picture, we don't see the refining margins in the fourth quarter on the level we have seen in the third quarter. We have started with a very low refining margin in early October, so we have seen a margin, which was below the USD 3/bbl. And if you ask me, what is the refining margin level in the fourth quarter, well, I don't feel comfortable really to raise a number, but I will say it's depending on the oil price development. What we have seen is that the refining margin and the customers are reacting in the Downstream business when the oil price is surpassing the \$80 per barrel. Now we are below that so that we can get a little bit more fresh air with the refining margins. But looking into fourth quarter, I would say, it's more 3 to 4 than 4 to 5. But again, it's depending what oil price we are going to see in the next weeks to come.

Petrochemicals

Question by **Michael Alsford – Citigroup**:

On petrochemicals, I'm just wondering if you can give a bit of an outlook on how you're seeing margin progression into '19. Are you seeing any sort of real demand weakness given high prices? And just a bit of color on that would be great.

Answer by **Rainer Seele**:

Yes, Michael. I'll take your question on the petrochemical market. We don't see real substantial downturn of the petrochemical cycle right now. It's a bit too early. And give me the time, the remaining 2 months until the end of the year to give you an idea of how 2019 will look like. Right now, we see that we still have a healthy market environment. We have in the different regions a different situation. I see it a little bit more positive on propylene than on ethylene, but the picture can change from one day to another. So the availability of ethylene is a bit higher than the availability of propylene, this has also to do something about the production capacities in the United States, that they are not too rich in propylene. That's the reason why I think the petrochemical margins are quite, quite stable until year-end. So I don't see any change at the horizon for 2019. Let's wait and see how the overall situation in the market will develop. Then I also have a better idea of whether or not we will see a downturn or slowdown of the GDP growth in 2019.

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