OMV Q4 2017 Conference Call – Q&A Transcript

OMV published its results for January–December and Q4 2017 on February 21st, 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

1. Dividend policy:

Question by **Joshua Stone – Barclays**:

I've got a question on the dividend, if you can talk us through your process assessing what sort of metrics you look at. You talk about an attractive shareholder return, so I presume you're looking at dividend yield, but also perhaps maybe payout ratios. Talking about growing cash dividend, I also wanted to confirm if that means we should interpret the EUR 1.5 per share as being a floor.

Answer by **Reinhard Florey**:

Josh, on the dividend, first of all in the consideration for the proposed dividend of EUR 1.5 we kept exactly to the dividend policy we have given out. Which means that we looked at our free cash flow and our net income both have clearly improved. Then it is very much about the strategy that we have, to gradually increase the dividend payments with the environment that we are in, within our abilities. Given for instance in 2017, we had the chance to finance all our acquisitions more or less from the divestments and entered into a very good free cash flow situation, which gave us the room for an even larger dividend increase from 2016 to 2017 than from 2015 to 2016. Our intention is to keep the dividend on a rising level. We have not said that 1.5 is the floor, but the intention is clearly to see that we are in a position to live up to the dividend policy that we have. All our strategic plans, which you will hear about on March 13, are in line with that.

Answer by **Rainer Seele**:

Well Josh, we do know that the dividend yield of OMV is not in the top league. Given that we have that always in mind, I think, it's another convincing argument that we are targeting a progressive dividend policy. Depending, of course, on the business development and the financial situation of the company, it shall go up and not down. Therefore I think we should not discuss any floor.

Question by **Marc Kofler – Jefferies**:

I notice you talking a lot about predictability around dividend. Can you just say a few more words about that? Were you tempted to consider a dividend policy going forward that offered a bit more color in subsequent years beyond 2018?

Answer by **Reinhard Florey**:

Regarding the dividend, I think we have expressively mentioned what the reasoning of our dividend policy is. And I think that we give you the guidance we're looking into. A positive development of the company, strategic growth and the intention to live up to the dividend policy, which states that there would be an increasingly higher dividend over the years. The intention is also, that the dividend yield goes away from being at the very bottom of the peer group. However, we have seen in 2017 simply an extremely positive development of the share price. I think we shouldn't complain about the dividend yield. The total shareholder return that we have achieved in 2017 is 61%. So this is clearly at the top of the group. We have to take that into account. I understand and fully appreciate the stability of a dividend paid out. We have lived up to that dividend policy that we have given in 2015 for 2016 and in 2017 and our intention is to continue like that.

Answer by **Rainer Seele**:

Mark, since we have announced our new strategy two years ago, we have now increased the dividend twice. What shall I do different to give you a good guidance?

2. Earnings Per Share

Question by **Mehdi Ennebati – Societe Generale**:

Just another small question regarding the EPS trend. So you have been able to materially improve your EPS in the last 2 years. Now given that you've sold Petrol Ofisi, which was positively impacting the EPS and given that you expect a downward trend in the refining margins, do you still think that you will be able to grow the 2018 EPS versus 2017?

Answer by **Reinhard Florey**:

The question was, whether you would see a further increase in earnings per share? If you look at the earnings per share development as such, we are, of course, looking at that very much from our operating result and then from the tax rate that we are seeing. So if you look at it in total we are expecting, with the oil prices slightly increasing compared to 2017 and the Downstream side being affected by slightly decreasing refining margins, we would see roughly the same level of activities there. Of course, this depends very much on the volume development, which we cannot entirely foresee. On the tax situation you will see, that some of the tax loss carried forward will be depleted in 2018. So tax rate might rise for 2018, compared to the 25% that we had in 2017, by the way, exactly what we had predicted. In that sense it is hard to progress. We are not guiding on the EPS 2018 right now, but it might be in the same ballpark or slightly lower, this is probably something that you could put into your models.

Answer by **Rainer Seele**:

Well, Mehdi, when I was listening to Reinhard one thing is obvious, there are too many question marks left that we can give you a clear guidance on the EPS for 2018. Give us a little bit more time on how the numbers are kicking in during the year, and I promise you, you will get a better answer from us.

3. Hedging:

Question by **Mehdi Ennebati – Societe Generale**:

You were also talking about unrealized hedging losses at the end of 2017, so there might be negative cash impact in 2018. Can you just tell us the relative amount of those unrealized hedging losses?

Answer by **Reinhard Florey**:

Regarding hedging policy, of course, we are taking some steps in hedging, but we are not in any way speculatively hedging. We are looking at hedging as more of a defensive strategy, in order to secure our profitability basis that we have. Regarding the hedging intakes in 2017, in total we have slightly negative effects from hedging, specifically in the fourth quarter. If we're looking into hedging for 2018, I cannot predict any kind of impact there, because the volatility of the oil and gas prices would predetermine that. But yes, there is a certain amount of hedging in place, and specifically when it comes to Russia we are trying to protect ourselves against downsides.

Question by **Mehdi Ennebati – Societe Generale**:

So if you know that the hydrocarbon prices remain at the current level, should we expect material negative impact or material positive impact in terms of hedging?

Answer by **Reinhard Florey**:

It is very difficult to take assumptions there. You have seen what the development in Q4 was and the effects in Q4. The situation in 2018 will be probably a more balanced one. It's very difficult to say how oil versus gas will develop, because the direct relationship between the prices has been clearly weakened. We are trying to take our own internal expertise to optimize what we can.

4. M&A

Question by **Hamish Clegg – Bank of America Merrill Lynch**:

And leading on from that, there have been a few headlines this morning, just reading in the press during the call even about potential M&A. If you could maybe update us on the situation, particularly, in Abu Dhabi? And what the scale of that could be?

Answer by **Rainer Seele**:

In Abu Dhabi, it's very obvious that we do have an interest to increase our activities, depending on opportunities which might arise. Which opportunities might arise, I don't want to speculate with you, but what I can say is that OMV is targeting, and we will elaborate more on this strategic idea, to build up integrated business in different regions. Especially in Abu Dhabi we are thinking more about an integrated corporation model, with our partner at ADNOC, than a purely asset-based production model. So that's a reason why we have signed in May last year an agreement with ADNOC that we jointly elaborate opportunities to work together also in downstream. So this is more or less in our focus. How long it will take, Hamish, what I have learned in the region is that our partners told me that, Rainer, you are owning the watch, and we are owning the time. And that's why I hate to wait, but I think I have to show more patience. But what I can say is, during the year, in 2018, we would like to have a clear picture on Abu Dhabi, and I think we will get this.

Upstream

1. Reserve replacement rate

Question by **Hamish Clegg – Bank of America Merrill Lynch**:

Another impressive result. A few quick ones for me. I wanted to check on what your organic reserve replacement would've been without the deals? And if you can confirm to us your 1P and 2P resource base, so we can better understand that.

Answer by **Johann Pleininger**:

Hamish, I will give you 2 figures on reserve replacement rates, but I will not disclose all the details. As you might know reserve replacement rate is driven by revisions, existing fees, projects, new projects coming on stream, like Nawara, Aasta Hansteen, Neptun, where you can expect more in the upcoming future, E&A activities and M&A activities. But we don't disclose the figures on all those categories. What I can tell you is that our one year reserve replacement rate in 2017 climbed up to 191%. In the 3 years average the reserve replacement rate went beyond 100%, exactly to 116%.

Answer by **Rainer Seele**:

If you remember what we have said what our replenishment strategy at OMV is. We have reduced our E&A spending, dramatically, from a level of 700 to now last year below 300. So the contribution can't be at that level we've seen in the past, but we have clearly said that the major reserve replenishment in the next years will come by acquisitions. The organic reserve base is the small number compared to the total number, which is fully in line with our new replenishment strategy.

2. Natural Decline

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

So if we look at the guidance for production in 2018, the 420, and if we exclude the Russian additions and compare it to the underlying number in 2017, it looks like you're guiding for about a 6% decline in your underlying production. I just wanted to check that that was the right impression. Of course, the obvious question is how does OMV plan to offset those declines?

Answer by **Johann Pleininger**:

I give you the figures from 2017, in Romania and Austria we saw a 3% decline. The same we do expect for 2018, even if we could improve it, because we increased our drilling program, as well in Austria as in Romania. In Libya, if everything goes very well, we see an upside from 25,000 to 30,000. So if you add this you would not come up with the 6% decline, but what we want, what we're promising, we will deliver at the end of the year. We have a very good start at the beginning of this year, but there are some plans like maintenance shutdowns in the course of the year. These are included, and also some uncertainty from Libya.

Answer by **Rainer Seele**:

We roughly start with conservative numbers in the beginning of the year. We will give you better guidance in our next Q1 report of 2018.

Question by **Giacomo Romeo – Macquarie**:

Perhaps if you can talk a little bit more on what sort of investment you're doing in Romania and Austria to offset production decline? You already partially touched on that, but it would be interesting to hear to what extent you're stepping up investments there.

Answer by **Johann Pleininger**:

We are planning to invest in Upstream in 2018 EUR 1.3 billion, thereof in Romania roughly EUR 600 million with EUR 100 million going to the Neptun investment. We are drilling in Romania around 115 wells compared to 63-65 wells in 2017. We increased substantially on our drilling activities in Romania and this will also help to minimize the decline. We are doing the same in Austria. In Austria we are going to drill 16 wells with 1 drilling rig. In that drilling program we will drill from the 16 wells four exploration wells thereof we will drill two key wells. So this is explaining more or less how we want to minimize the decline. And as I said before, the decline in 2017 was roughly 3% in Romania and Austria, with less drilling activities than what we planned for 2018. So there's a good chance that we even come out with a lower decline rate at the end of 2018, than in 2017 for Romania and Austria.

3. Yuzhno Russkoye

Question by **Mehdi Ennebati – Societe Generale**:

Regarding the dividend that you might receive, can you please tell us what will be the dividendor the remaining dividend that will be received from Yuzhno Russkoye for the year 2017? And when would it be?

Answer by **Rainer Seele**:

The total dividend from Yuzhno Russkoye as I have said for 2017 is roughly $160 million. The dividend from the trader will be paid in 2018. We have received a dividend payment from the operating company Severneftegazprom already in 2017 in the order of magnitude of EUR 15 million. The other part was considered in the purchase price adjustment. So, that's a little bit more complicated. But from a cash perspective take the EUR 15 million for 2017 and the rest up to $160 million will be paid then as a dividend in 2018.

Question by **Joshua Stone – Barclays**:

A quick housekeeping question on realized gas prices, I wondered if you could just say what those would've been in the quarter if you didn't have the Yuzhno volumes in the mix.

Answer by **Rainer Seele**:

Your question, Josh, is a very delicate one, because for some reasons, which have to do with confidentiality, with the agreements we have signed, we would like to keep some information really confidential. What we don't want to disclose is the pricing formulas we have together with Gazprom on the Yuzhno Russkoye production. All we can do is to give you some guidance about the structure of the pricing model. The gas price in Russia is a state regulated price, which is published for a 3 years period. And the German border price with a net back calculation is also published. This is the only guidance I can give you, as we don't want to release any prices, neither the prices we have in Russia nor in some other regions.

4. Achimov

Question by **Hamish Clegg – Bank of America Merrill Lynch**:

I know we're still waiting on Achimov. Could you confirm, just for the more ESG-minded people, what the corporate governance issues actually are with Gazprom?

Answer by **Rainer Seele**:

The Achimov's transaction. Well, one thing is clear, we have to sit together and we have to decide on how we would like to work in the two companies. In the development of the Achimov reservoirs, and in Norway where we do have the existing business. The main questions we are discussing are how many managers we can send into the companies in Siberia and how many managers they can send into our company in Norway. What the business model is that we have in mind. What are the business plans we would like to agree on. What is the development plan and so on. So, on all these types of questions we have to find an agreement together with Gazprom. One thing is clear, I would like to have a big influence in Russia and I would like to avoid a big influence of my partner in Norway. And this is describing the conflict we have to solve together, and this is taking time. We have in our master plan the milestone that within the year we are going to solve these issues and we are going to start the application for the necessary approvals in Norway as well as in Siberia. We plan that the approval process will take some months. We don't have any experience so far, on how long the approval process will take, but this is what we have in our plans. Following that schedule we are targeting to close the swap transaction at year-end.

5. Domino

Question by **Giacomo Romeo – Macquarie**:

Can you perhaps talk a little bit of the progress you're doing towards FID at Domino?

Answer by **Johann Pleininger**:

Regarding Domino, we are progressing with the project. We are expecting to take FID beginning of the second half of 2018, and we're expecting first gas in 2020 and 2021.

Question by **Mehdi Ennebati – Societe Generale**:

Just a follow-up question, on Domino. You just said that you expect to take FID beginning H2 2018. What kind of break-even price are you working on and are you targeting for this gas project?

Answer by **Rainer Seele**:

Mehdi, please understand that we don't talk about prices. It's a general policy, especially not the breakeven price. Because then all the potential customers would know what price I need at minimal when negotiating contracts. So please understand that I don't answer your question on prices. All I can say is that we are looking for prices abroad of Romania, and we have to start an intensive marketing program. That's the reason why we are so closed on making any comments on prices. We first have to lock in the contracts with potential customers. So please understand that we cannot comment on this.

Question by **Mehdi Ennebati – Societe Generale**:

Can you tell us what kind of internal return rate you are working on for Domino?

Answer by **Rainer Seele**:

No, I think we have a general policy that we have a certain threshold for the investments we are taking, and this also applies to the offshore project of Romania. We need to have a double-digit percentage rate of return after-tax. That's the main criteria we have. It can be higher, much higher, but not lower.

6. Outlook for Libya's production

Question by **Henri Patricot – UBS**:

One question on Libya, your guidance for 2018 is 25kboe/d, which is flat, compared to 2017 average, but down from the 32,000 you have in the fourth quarter. Is that because you are being a bit conservative, or has the situation deteriorated so far this year? And secondly, what could be the upside case if everything goes well this year in Libya for your production?

Answer by **Rainer Seele**:

As we speak about our production capacities we have and we could drive in a quarter, we are talking about a level of 30,000 barrels per day. The number we take into our calculation is strongly depending on how much infrastructure for the export of our production is available. As a good educated guess, we have said we take the same situation as of last year for 2018. If the entire infrastructure, the pipeline transport to the ports, is available then there is an upside to the 30,000 barrels per day.

Question by **Henri Patricot – UBS**:

And what is this upside potential?

Answer by **Rainer Seele**:

5000, so from 25 to 30.

Downstream

1. Nord Stream 2

Question by **Mehdi Ennebati – Societe Generale**:

Regarding the additional payments that you could do to Gazprom this year, in 2018, related to Nord Stream 2. Can you tell us what could be the maximum payment? Do you expect it to be reimbursed after the closure of the project financing with the capital markets?

Answer by **Manfred Leitner**:

You know that in 2017, we have spent EUR 324 million on Nord Stream 2. There is no maximum amount for 2018 because we will be financing in accordance with the progress of the project. And at the same time, there will not be and there have never been plans that any project financing already will kick in 2018, but only in 2019.

2. Smatrics

Question by **Hamish Clegg – Bank of America Merrill Lynch**:

Could you explain to us SMATRICS and your renewable strategy? Is this really just keeping up with your peers doing a few things, or do you honestly see this as a cash contributing business line?

Answer by **Manfred Leitner**

First of all what we experienced last year was a significant increase in the demand for diesel in our market. And gasoline was more or less stable. I think this is something which already gives you a certain idea whether we see this as a new business segment that we're building up, or whether we trust what we're really actually having in mind to offer our customers, a broader alternative fuel offer at our stations, to make them more attractive, not to fall back behind competition. And that's the main topic that we're having, because what we need, obviously, to prepare for is an increase in electrical mobility. This is coming. SMATRICS is, in Austria at least, the most comprehensive provider of e-mobility services. If you see for instance the joint venture that has been mentioned by Rainer before that, IONITY, this is going exactly into the direction that we like to see. The car producers are joint venturing in order to invest into stations. To invest into our stations is better than to invest in the stations of our competitors. At the same time SMATRICS will play a role here, because they will have the power management at their station, so that we get a synergy out of it on top of it. But I can reconfirm that we are not building up, not for the time being, a new business segment that is called alternative fuels.

Question by **Hamish Clegg – Bank of America Merrill Lynch**:

So to be very clear, it's about sustaining your market share in the retail business, correct?

Answer by **Manfred Leitner**:

Exactly, what we've done on the fuels, on the fossil fuels to be specific. We have increased our retail sales volumes last year by 5%. This is more than the market growth, so obviously we have increased our market share, even before falling back on the support of the mobility.

3. Outlook for Borealis dividends

Question by **Mehdi Ennebati – Societe Generale**:

Regarding the Borealis dividend, when will you know what the dividend level will be? Are you expecting something which is relatively close to what you received last year?

Answer by **Rainer Seele**:

Yes, Borealis is doing a good job, you're absolutely right that they have repeated their record year with EUR 1.1 billion net profits. They haven't decided on the dividend. Am I hungry? Of course I am, Mehdi. But can I decide it, no. So we have to wait for the decision from the Borealis management, what they want as a dividend level. We have to wait another week then we will have a clear answer.

4. Outlook for refining margins

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

On the refining margin comment you published in the outlook, how much lower year-on-year do you envisage it. Is 4Q 2017 at $5.7 a barrel a good indicator for 2018? Or should we be thinking higher or lower?

Answer by **Manfred Leitner**:

To give you now the refining margin in very much detail for 2018 would not be very responsible. Why we believe it will be lower than 2017 is simply because in 2017 you had a few incidents that have been one-offs, for instance hurricane Harvey in the third quarter in the US. At the same time in Europe, there have been some outages, which have been unplanned, such as the Pernis refinery, in the Netherlands. If you take that together, it's very difficult to get it into the detail of the numbers in the digits, but I believe, it could be something like above 5 on average for 2018, if there are no one-offs repeating.

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