OMV Q4 2020 Conference Call – Q&A Transcript

OMV published its results for January–December and Q4 2020 on February 4, 2021. 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 clarity.

OMV Group

Transition to chemical company

Question by **Peter Low – Redburn**:
Is the ambition here to have OMV considered a petrochemical company rather than an integrated oil company. And over what timeframe do you think that transformation could occur?

Answer by **Rainer Seele**:
As early as possible. I know that you are disappointed to hear that, but it tells you that I would like to ask you to wait until our Capital Markets Day, because this is the main topic. We will discuss with all of you, it will headline our sustainability strategy and the transformation into chemicals. And because I like all you guys, so much. I would like to see on our Capital Markets Day. That's the reason why keep it as the secret.

Capital allocation

Question by **Sasikanth Chilukuru – Morgan Stanley**:
You kind of provided a scenario where in the cash flow from operating activities can increase to more than EUR 5 billion by 2025. The CapEx numbers are between 2.5 to 3 billion. So there seems to be a lot of room for the free cash flow. That could either go into the dividend or can reduce the gearing levels. Your target for gearing ratio is less than 30%, which you could probably get to in 2022. I was just wondering, how would this additional free cash flow, what is the pecking order, if it were between shareholder returns and gearing levels? Is there any hard targets for the gearing levels to come down even further? At what level and what are you thinking regarding the growth in the dividend levels?

Answer by **Reinhard Florey**:
You're right, our ambition is very strong and I think the operational platforms are already in place that, with the economy recovering, a level of 5 billion cash flow is in reach. Now, of course, if you take the CapEx, we have given you indications on the organic CapEx, and organic CapEx certainly is something that, if there is a headroom, can be also accompanied by some inorganic CapEx. Now, for the next years, we clearly have a prime target to deleverage. We have on the other hand shown that we are able and willing to take shareholders' interests very serious. We have announced a dividend increase even in this year. So there is not a link that is direct to say, if we deleverage, we cannot give dividends or raise dividends. We are demonstrating that the financial basis is strong enough to do both. And you're right, our ambition, by the end of 21 or in 22, to have the 30% gearing or below, will then start to give us a headroom and in that, there will be all levers. Again, to have strong financial framework, to have a solid dividend paid out to our shareholders, and the ability to strategically grow, will all be served by the delta between the 3 and possibly 5.

Answer by **Rainer Seele**:
I know Reinhard now since 5 years, and he always wants to keep the cash in his pocket. So the priorities are quite clear. We would like to deleverage, we would like to bring gearing down. And then, the second priority is our progressive dividend policy. So I'll leave it with your fantasy what Reinhard will do with all the cash. But the priorities of capital allocations are set.

Dividend

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

If you go back to this time last year and you announced a dividend increase to EUR2. What magical formula did you base it on? And obviously you ended up keeping it flat because of Covid, and now you've announced the increase from 1.75 to 1.85 what magical formula did you use here?

Answer by **Reinhard Florey**:
Considering that dividends always are paid for the previous year: 2019 has been a record year. And therefore we decided that without the knowledge of the adverse development through the pandemic, in January last year we still anticipated a little bit better economic environment. Therefore, we felt that for a record year, an increase in dividend is justified. We took it back to 1.75, which still is a record level at that time, because of the pandemic, but also we took the leap of faith to say we will come strong through this difficult year and therefore we will not cut back as many of our peers did. I think we showed that we can do that. And now we are seeing that, while 2020 the year for which we pay the dividend for was a very difficult one, we see a little bit light of the end of the tunnel of the pandemic. And therefore, it's not a big increase, but it's a signal of strength. It's the signal of appreciation for our shareholders that in this situation, we already take this increase. And that is the magic formula, it's a lot of thought that go into that, but there is no formula, I'm afraid.

Hedging

Question by **Henri Patricot – UBS**:
On the hedging decisions that you've made. Can you give us a sense of the policy behind that and what we can expect in the future. On what basis do you decide to hedge, both on the upstream side, hedging the oil production and also on the refining side. Should we expect to see ongoing hedging? Is there anything particular where you decided to hedge this time.

Answer by **Reinhard Florey**:
First of all, we have clearly hedging as an instrument both for operations as well as for defensive financial measures. For operations, specifically on the Downstream side, we see it as a common tool to make sure that we do not have any kind of open positions and make sure that we can have a stable situation of our turnover, versus market volatility. On the upstream side, when it comes to commodity hedging, we look very carefully on what are the specific goals that we are pursuing with the company. 2021 is certainly a year where deleveraging and the focus on cash flow delivery is first priority. So if we have situations in the market where we see a clear upside versus our initial plannings and initial assumptions that we had, there will be certain portions that we keep as a means to hedge. This is exactly happening with the volume that we have hedged now for the first half year, where we have seen a very good pricing level on the oil side, and therefore we decided a certain portion, and it's a modest portion to be honest, to be also hedged in order, to make sure that the cash flows for this year and the deleveraging targets are in line.

CAPEX guidance

Question by **Thomas Adolff – Credit Suisse**:
On the, CapEx range of 2.5 to 3. I think you mentioned Borealis will peak, in the next few years. And after 2023 will fade, where is that, are you going to stay in that range beyond 2023 and if Borealis' spending is declining, in which areas are you ramping up spending.

Answer by **Rainer Seele**:
First of all, the majority of the CapEx we have now planned until '25, we will use, like Hans said, for our high-value upstream pipeline, to keep the production level we see nowadays. Secondly, when we -- you're absolutely right. Borealis is peaking at a point of time and then Borealis is declining, but I would like to clearly express here that OMV chemicals will be more than Borealis. So I leave it to your fantasy what else could be invested for. But there must be a story upcoming until '25, which means it's more than Borealis.

Question by **Peter Low – Redburn:**
Given the shift towards running the Upstream business for cash, can you give an indication of how much of that EUR2.5 to 3 bn of annual CapEx will go into upstream?

Answer by **Rainer Seele**:
I can give you an idea about the share of upstream in our CapEx budget for 2021. It's about EUR1 billion to EUR1.1 billion. The years after, let's wait and see how the projects are going to be executed. So therefore, take this as an indication for 2021.

Divestments

Question by **Mehdi Ennebati – Bank of America**:
So you've announced a second tranche with the potential sale of the Nitro division and some assets in Slovenia. Just regarding the Nitro division, how confident are you regarding the disposal of that asset in the current environment? Would you say that there is an appetite for that kind of asset in the market currently, or not really? Did you already start some discussions with some potential buyer, or no?

Answer by **Rainer Seele**:
Let us first check the market before I give you a smell what is possible this year, you know. I think it's a little bit too early. Definitely I can remember last year when we made the announcement of our asset disposal program, you were all telling me it is so difficult. The market and because of COVID-19 and we could manage. And I am more than convinced that Alfred and his team will manage to sell this asset in the market. You are absolutely right, it's not easy going, but all the other assets we have sold last year were also not easy going. So I am confident we will not disappoint you all and we will deliver on the package we have announced.

Question by **Tamas Pletser** – Erste
Regarding your divestment of fertilizers, what is the reason you chose the fertilizer line to divest – was it the inferior return or the integration issues similar to your Slovenian retail network.

Answer by **Alfred Stern**:
We have previously and quite consistently actually stated that Europe is an interesting and important fertilizer market. And that at the right time, and the right conditions, we would be open to divesting the nitrogen business. Now over the last two years, we have successfully completed the turnaround program in the fertilizer business, to make it financially more robust. And this has given significantly improved cash flows of the business, and we believe now is actually the right time to take further steps. At Borealis, we will continue to focus on the core activities, which is basically polyolefins, base chemicals and circular economy. And that also fits well with OMV when it comes to the Group strategy development.

Upstream

Production Outlook

Question by **Thomas Adolff – Credit Suisse**:
Your target previously to go to 600 kbd you've now ditched to 450 to 500. Let's take the midpoint, 145 kbd difference to your prior target. Where is this production, or which projects are you foregoing, or you just phasing them and extending the plateau of the overall group?

Answer by **Johann Pleininger**:
Currently what we are forecasting for 2021, as Rainer said, is the 480,000 boe per day, not considering any shut-ins due to security constraints like in Libya as we had last year. So that’s the potential what we have right now. We have very good and very economic pipeline of projects like Neptune, Jerun, Wisting, Hades/Iris, SARB/Umm Lulu just to mention some of them, which are good enough, from my point of view, and which have the potential to keep the production level until 2025, where we are right now.

Question by **Thomas Adolff – Credit Suisse**:
I do remember, earlier in 2020, we discussed how production can grow. You've just talked about how you can sustain production, but you didn't actually discuss which projects you’re not developing, versus prior expectations.

Answer by **Johann Pleininger**:
You know what we have been saying and what we have been guiding is that we see Achimov IV/V as an opportunity and not as a fixed investment which we will take. So what I told you, this 450,000 to 500,000 boe range, which will be filled by the projects which I told you before is not including Achimov. And what you need to consider as well that we go over divestment program. So we have been selling already Kazakhstan, we are divesting Maari, we are divesting our oil assets in Malaysia. So only these 3 here we will lose between 15,000 and 20,000 boe on a yearly basis. So this is also compensated by the project pipeline, which we have.

Exploration spending guidance

Question by **Henry Tarr – Berenberg:**
You talked about upstream CapEx being around sort of 1-1.1 billion in the next couple of years. And you pointed to exploration spend coming lower, which it did for 2020. Should we expect exploration spend sort of flattish through 2021 and then, how are you thinking about exploration in the longer term?

Answer by **Johann Pleininger**:
We have been spending in 2020 close to EUR230 million. We will, we are aiming for the same amount of money for 2021. In the upcoming years, we will focus our exploration activities on Southeast Asia, Norway, and deep layers in Romania and Austria, where we have done already seismic activities. So we'll see how many wells we can drill there, but the main focus is Southeast Asia, because here we see also the very fast-growing market. And in Norway, that's a perfect play for exploration because you get 78%, no matter whether you are successful with your exploration. Whether you found hydrocarbons, yes or no, you get 78% back from the government. So this is the strategic view on it. So we will keep the exploration, it will go slightly down, so around 200 million. That's what you can expect for exploration spendings in the upcoming years.

Gas markets

Question by **Josh Stone – Barclays**:
Prices have been very high during the start of this year. So I was wondering if you comment on, to what extent are these Upstream portfolio has managed to capture some of that. I see that some of your Malaysian assets being linked LNG in Asia. And to what extent that could be a feature in the first quarter.

Answer by **Rainer Seele**:
We only can catch the lovely price increase in the European gas market only partially. I would love to have more but just remember, it's roughly 40% of the gas we produce in Europe which is following the pricing in the European spot markets. And just remember that we have these two months' time lag, especially with the Russian volumes and these are very substantial. So it's 50,000 barrels per day production which is with the time lag coming. So some of these price increases we have seen especially now in the first quarter, will move into the second quarter in our pricing. So this is just a comment on Europe and Hans will give you an idea about the pricing in Malaysia.

Answer by **Johann Pleininger**:
Thanks for the question regarding LNG also in Malaysia. You know, we had a detailed discussion about the LNG prices in Malaysia when we FID'd our Jerun project just recently in OMV. So what we have seen in the last year, we have seen $5-6 per mmbtu gas prices in Malaysia. We forecasted for the project that those prices will ramp up to $8 per mmbtu in 2, 3 years. What we see right now in the market is a much higher demand than forecasted just some months ago. We see already right now that the price is peaking beyond $8 per mmbtu. As I said, as we have been forecasting just some months ago that this will happen only in 2, 3 years from now. So what we see right now, is that demand is increasing due to the ramp up in China, but also in India. Just to give you one figure regarding India. India has just announced some I think 3-4 weeks ago that they are covering the primary energy demand by around 6% by LNG and gas, and they are aiming to increase this coverage rate up to 30% until 2030. This is already giving you a feeling how the demand for gas and LNG in this region will increase in the upcoming years.

Downstream

Demand outlook

Question by **Matthew Lofting – JPMorgan:**
I wonder if you could just talk about the sort of the trends, early 2021, OMV seeing on demand through its key downstream markets that would be appreciated.

Answer by **Rainer Seele**:
I think it will be good gas year, so the winter helps. So St. Peter really supported our business in 21 so far. If you look down the road, the price curve, it tells you that the gas prices you see now in the forward curve is nearly twice -- 3 times as high as we have seen it last year. As we see we a real high offtake from gas storages already in January in some countries, we are already below the 50%. I think this is supporting the price curve, especially in the traditionally or historically weak two summer quarters. So it could be a by far a better gas pricing year awaiting us.
What we can see in the in the downstream market, I think first half, and we really have to cut 21 into two halves. The first half, I think, especially the transportation sector, will really not be helpful on the volumes. So what I can see is that the refining margins, especially in the first quarter, we are now something between $2 and $2.5. We might move into a $3 to $3.5 in the summer quarters because driving season will start. But it's going to be a difficult refining year 21. So I would be surprised.
Chemicals: stable. They even persist Corona. So that's why I would say 2021 could be – could become a good chemicals year, the same listening to our Alfred is music in my year. This was a very nice welcome gift when I looked into the Q4 numbers, and that's a good appetite to continue in 21, of course.
When we look into the oil markets, I would say, I can see that there is a potential, of course, depending on how the global economy recovery will really look like in 21. But I think there is at least a potential that the oil market can be tight second half of this year. So what I can smell is of course a potential that we move into the '60s in the second half if we really see economy coming back, like many are forecasting. So that tells you that jet is making our business difficult also in first half, but second half comes in with a lot of hope what else markets.

Petchem Margin Outlook

Question by **Mehdi Ennebati – Bank of America:**
My indicators show relatively strong petchem margins at the beginning of this year compared to the fourth quarter for example or even the first quarter of last year. So I just wanted to know if you see the same thing happening for Borealis, and even the integrated petchem business, or no?

Answer by **Rainer Seele**:
What I see today is that petchem margins at the moment, starting into 2021, were a little bit under pressure because of rising naphtha prices. So, the feedstock prices went up, and now we see that we can adjust our chemical product prices accordingly. So it's on the way, but I wouldn't be now over optimistic that the first quarter is now the best we see in 2021. It's also depending how the naphtha and oil prices are going further up.

Question by **Michele della Vigna– Goldman Sachs:**
On the outlook for the polyolefin margins. It seems like there is quite a few new projects starting up in the next 24 months. I was wondering if you think there is any risk that from the supply side, you get some pressure on the margins over the next 2 years, from what has been quite a good environment in the last 3 months.

Answer by **Alfred Stern**:
I think you are correct. Last year in 2020, we did see some additional capacity coming on stream and it is also expected that in 2021 globally, additional polyolefin capacity will come on the market. However, what we do see is that many of those projects are delayed because of the pandemic. So there is a couple of months' delay and the second piece that we have actually seen is that in 2020, the polyolefin demand was much stronger than anticipated with significant growth rates. And that resulted in a very strong fourth quarter. Currently, we see still a very good demand for both polyethylene and polypropylene. However, the further situation will depend on 1) as Rainer said the feedstock evolvement and 2) in my view the development of the global pandemic and how that may impact the global demand.

ADNOC Refining

Question by **Tamas Pletser – Erste:**
On ADNOC Refining, what was the reason of this negative operating performance of this refining asset. Was it on the operational issues, or simply the market was too bad for ADNOC?

Answer by **Thomas Gangl**:
2020 was definitely a very difficult year for ADNOC Refining. We had a big turnaround in the first half, which is of course coming along, not only with cost but also with low utilization rate. And then the crisis, the COVID crisis really came in and we saw that especially with product portfolio, with jet being an important part of it, but also naphtha. It was a very difficult year. And therefore, it was also in terms of not only having the technical issues, also having the market issues. It was difficult. The good news here is that we have solved the technical issues that we had last year. For example, the RFCC, which is a key unit, is running now very smoothly above the planned utilization, original plan utilization. So this is now solved, but still this year will be a difficult one. If you look into refining margins in general, you can see that we need to get a better situation and this will only come along with more demand on the middle distillate side. We see all over the place that the low demand of jet for example is delivering an oversupply on the middle distillate side, and therefore the margins are challenged. But as said, the good news is the technical issues are gone. Solved.

Recycling

Question by **Michele della Vigna – Goldman Sachs:**
I was wondering if you could perhaps help us understand a bit more the economics of mechanical recycling versus chemical recycling and pyrolysis and where you think there is the best opportunities in the coming years.

Answer by **Thomas Gangl**:
You're absolutely right, it's not an easy one, with the economics, if you have just one type of recycling. But this is the beauty of what we are doing together now with Borealis. We have on one hand the mechanical recycling expertise, and then we have the chemical recycling. Because if you do just mechanical recycling, you have the problem that you have a lot of material that's not recyclable. And you can use that in the chemical part. And with that we think more in the direction of recycling hubs, where we combine these two technologies. And I think there are not many companies who can say that they have the technology to do those two things together, plus having the knowledge about the products, having the knowledge about processing the synthetic crude. And all of that is now in our portfolio and therefore we believe that this is definitely something where we can make money with it.

Question by **Josh Stone – Barclays:**
I'd just like an update on the ReOil project, just see where are we now, how close are we to being able to scale up that business or that project. And I guess just linked to that more broadly, do you think for this industry to grow, does it need further help from the government or not?

Answer by **Thomas Gangl**:
So you know we have a pilot plant at Schwechat refinery where we can process 100 kilograms per hour. So this is of course not the big unit that we want to build, but this is a very important one to really understand all the operational topics. We had really very good progress over the last months. We processed several hundred tons of material there with the different qualities, because it's really about making sure that we fully understand where is the optimal point to process, in terms of which parameters do we use for the different feedstocks. So this is something where we have really clarified what is required for the next stage. And therefore we are already in the phase where we design the new unit. And there will be news this year on the next step. So we are looking forward to give you more on that later on, but good progress, operational topics really developed very nicely, and the unit is continuously running. So we are in a good stage.

Question by **Henry Tarr – Berenberg:**
To what extent do you think over time recycled polyolefin and the recycled demand for recycled polyolefin to cannibalize potentially virgin polyolefin demand?

Answer by **Alfred Stern**:
To start with, I would like to say that we anticipate continued strong growth for the polyolefin demand area, that this will grow with 3 to 4% going forward, so growing above GDP rates. So that's the overall demand. The question that we are treating here is where will the feedstock come from. And we anticipate the year that increasing recycling rates will come. I maybe give you two data points here. There is a McKinsey study here that was extrapolating that by 2050, up to 60% of the polyolefin demand could be supplied by recycling. And then there is a European regulation. The plastic packaging waste directive that is requiring that by 2025, half of the plastic packaging should be recycled. And this is what one should look at. This is why OMV and Borealis, we think this is a significant growth area. We don't see that it will cannibalize the polyolefin demand, but it will change the feedstock supply to the polyolefin production. And that's what we see as our strategic opportunity here with Reoil or with Borcycle technology.

Borealis

Outlook

Question by **Bertrand Hodée – Kepler Chevreux**:
Is there any inorganic CapEx in Borealis, this year. I'm thinking about the funding of the JV Baystar. And if there is, can you quantify it?

Answer by **Reinhard Florey**:
Regarding inorganic CapEx on Borealis. There is the project of Baystar in US, where you will still find a couple of investments respectively capital injections, and this will be in the magnitude of some 200 -- 300 million in the next year. Other than that there is no inorganic CapEx, but of course the organic CapEx that Alfred described around the project in Kallo, as well as of course projects in Borouge.

Question by **Bertrand Hodée – Kepler Chevreux**:
Very strong performance in Q4 by Borealis, and overall obviously operating profit was down in 2020. But given what you see, could we expect Borealis operating profit in 2021 to come back at least to the level of 2019. Is that - would that be a fair, I would say a view at this stage in 2021?

Answer by **Rainer Seele**:
I of course do have a big hope that they are coming back to the 2019 level of course. But nobody, especially in the current situation is giving you a little bit of an idea how this in 21 will develop, because I think the uncertainties, especially as we are talking about at the beginning of the year in February. I would say, ask this question again on the Capital Markets Day, I'm inviting all of you, making it worth to come and listen to us. Then we might have a better idea, because I'm expecting that second half might kick in with a better framework and then we might can give you a better answer and a more positive outlook.

Question by **Bertrand Hodée – Kepler Chevreux**:
On dividend of Borealis to Mubadala minorities. Can you provide us a feel on what would be the Borealis dividend policy going forward?

Answer by **Reinhard Florey**:
We are not disclosing dividend policies, as Borealis is just between Mubadala and OMV. But for the coming year, for 2021, we are expecting that, in general, not differ too much from the year 2020.

Borouge

Question by **Henri Patricot – UBS:**
I was wondering if you could give us a sense of the CapEx outlook there. If you go ahead with the expansion in particular and what that means for the dividend outlook, for the dividend from Borouge.

Answer by **Alfred Stern**:
There are two different projects in Borouge. One is the 5th Borstar polypropylene plant, the PP 5 project. In this project, we are almost coming to the end. We are close to 90% complete and anticipating start-up in the third quarter of 2021. It's about the 10% capacity increase for the total Borouge complex. On the bigger project, Borouge 4, the fourth stage there, we are currently in what is called the front-end engineering and design phase and trying to understand and optimize the complex what it should look like. So it's too early to make any comments on the CapEx there.

Borstar technology

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

The comments on the Borstar technology was very interesting. I wonder if you could expand on that a little in terms of what it is about the Borstar process that differentiates and enable you to meet the elevated standards that were referenced.

Answer by **Alfred Stern**:

I think it's also a key differentiator for the company. Let me, maybe start with saying that we did over the last 25 years, but continue also, to invest significantly into innovation and technology in Borealis. And flagship technology there is the Borstar technology. With this technology you can produce both polyethylene and polypropylene. And we use this technology only for our self or for venture partners, so in our joint ventures. Meaning we don't license it to the market because we believe that the differentiation we can achieve with it allows us to be more competitive. So what is that. What happens to the products that we make with our Borstar technology. The products that we make are actually lighter, tougher, stronger, and they can be faster processed than with other technologies. And that means that the customers that use our Borstar product, they can reduce cost, both in material savings, but also in productivity increases when it comes to processing the material. And the last piece, I would like to mention here is also that it appears that our Borstar products allow a higher mixing-in of recycling content, compared to some other products. Which is of course important in that context of circular economy that was discussed before. So, what we can do with Borstar then is make a product range and portfolio that is allowing us to be able to be present in those different segments that I showed in my presentation. And then, like I said, quite some investment into our technology, but also in our catalyst development capabilities to make sure that we can drive these innovations further on together with our customers. And continue strengthening our brand name and our customer relationships, but this is a very long topic and I will then also say if you have time and can join in the Capital Markets Day, we can spend hours talking about this.