

OMV Q2 2021 Conference Call – Q&A Transcript

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OMV Aktiengesellschaft

OMV published its results for January–June and Q2 2021 on July 28, 2021. The investor and analyst conference call was broadcast as a live audio– webcast at 11:30 am CEST. Below is the transcript of the question and answer session, by topic, edited for clarity.

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OMV Group

Company transformation

Question by **Matthew Lofting – JPMorgan**:

Congrats on a super strong quarter. I think, Rainer, record numbers, very well deserved as a sign-off, wishing you well. And Rainer, I think as you referenced in your opening remarks, it was a significant macro volatility through your tenure at OMV and also significant company transformation. At the same time, clearly the whole industry is having to adapt to the transition. So, I wonder if you could share some thoughts on what some of the most challenging elements of the transformation of the company today have been and perhaps sort of forward learnings from that?

Answer by **Rainer Seele**:

Thanks, Matt. Let me start with the topic of transition. I think the most challenging part, especially as we speak about transition into low carbon world, is timing. The expectation in the political arena and in the financial market is let's do it yesterday, because we have to save our planet and do it as quickly as possible. What I have learned is transformation takes time. It really takes time. What I can see in OMV, we have been I think more an exception for fast transformation. If you look what happened and just see the first half year results, 50% of our overall earnings performance is attributable to chemicals. And what I have learned is if you would like to go for quick transition nothing goes quicker than M&A, and you have to be bold. And the most challenging part is, you have to give up what you love. You can't imagine if you grow up successfully in oil and gas and if you tell the people in the long run, we would like to transition into a totally different company, it takes time to convince people in the company and you have to give the company and the management the time to work on that job. Don't make too much pressure that you would love to see a transition happening from one day to another, it's impossible. But be impressed, if a company is explaining you a strategy that via M&A, they are ready to reduce their traditional business and they would like to fast grow into the new world of business. What I have learned is when you are going to invest into a wind park, you are busy five years to build that and then you will enjoy hopefully, having it into your numbers. A transition via investments takes a very long breath. So, that's my experience. Transition is not an easy task for management to execute.

Borealis minority shareholders dividend

Question by **Sasikanth Chilukuru – Morgan Stanley**:

First of all, congratulations Rainer, for your successful tenure at OMV and wish you all the best for the future. Related to the dividend payments to minority shareholders for Borealis. You have highlighted dividend payments of EUR 38 million for the first half of this year. If you could remind us what the dividend policy of Borealis is and what payments can we expect in the second half of 2021 that would be helpful?

Answer by **Reinhard Florey**:

Sasi, let me explain to you a little bit how the dividend policy works. So, we normally have a policy that we pay dividends once a year. There were some periods where there has been a split of the dividend with an anticipation of part of the dividend already in the quarter before. But if we are talking about 2020 and 2021 that will be paid out in one tranche. So, it is not expected that there will be additional dividends to be paid out in the rest of the year. Whereas I wouldn't feel too sorry for Mubadala, they got a very rich dividend from OMV for their 24.9% share in OMV.

Net working capital

Question by **Sasikanth Chilukuru – Morgan Stanley**:

Related to the net working capital build of EUR 810 million in the first half, do you expect this or a part of this to reverse over the second half?

Answer by **Reinhard Florey**:

The net working capital increase in the first half was more or less attributable to the very high price increases that we have seen that came in both in inventories as well also in the ratio between payables and receivables. We are expecting that this eases out for the second half of the year. I would be too bold to say it reverses. So, as we are seeing that some of the prices are, I would say weakening a little bit in the chemicals part, but on the other side, we are seeing still quite, quite high prices. I would expect that there might be a little bit of a positive net working capital contribution when it comes to cash flow, but not very high. So, think of it as being rather stable for the second half of the year.

Exploration & Production

Realized gas prices

Question by **Matthew Lofting – JPMorgan**:

You flagged some of the drivers behind European price strength earlier on. Can you talk a bit about the outlook as you see it for the next 6, 12 months and scope within that for further gas realization upside, OMV versus I think sort of lower 11s/MWh in the first half of the year, given the lagged mechanism and some of the pricing regimes?

Answer by **Rainer Seele**:

Gas, what is my outlook for the next months to come. I think, Matt, we are going to continue to see high prices in the natural gas market during the summer months. The demand for storage gas is absolutely high. The compressor capacities at the storage sites are limiting us to refill the storage if the withdrawal season would start early. For example, if you had a scenario that in October, we see first snowflakes coming, then we will have very high gas price scenario for the winter quarters. So, an early arrival of the winter temperatures would feed an upside scenario and then you are going to see also in the winter quarter, a spark spread coming back. Then we might see summer gas prices being topped also the winter quarter and it's depending, on an early arrival of the winter. But if you look into the forward curve, you will see that you have something around EUR 25/MWh to EUR 30/MWh. As a gas producer in Europe, I would say a very healthy business is waiting you, so you will make good money as a gas producer in the next quarters. I don't see that there will be a drop of gas prices to a level, we have seen last year for example, in the low-10s. So, more or less, my basic scenario is telling me we have to live also in the next months more with higher than lower gas prices, not higher than we are seeing right now, but higher compared to the quarters we have seen last year.

Hedging

Question by **Mehdi Ennebati – Bank of America**:

You said that you hedged 10% of your gas production. Are you talking about your total gas production, your global gas production for the second half of 2021? And can you please tell us what portion of your European gas production did you hedge? So, if you can answer on those two questions, that would be great. And I will finish by saying to you Rainer that I wish you the best for your next steps in your professional life. It has been a real pleasure and quite exciting in fact, to cover OMV with you as a CEO and sincerely, I wish you all the success that you get in your next positions.

Answer by **Rainer Seele**:

Thank you very much, Mehdi for your personal wishes, which I will also revert to you. All the best to you, enjoy the further development of OMV. Gas hedging, absolutely correct, 10% of the global gas production of OMV has been hedged. It's the entire global production as a reference to this 10%. And European gas production, please forgive me, don't want to add too much into details. It's because I have looked around the table already and nobody can hand over a number to me. So, Mehdi, please forgive me, nobody is giving me any number, so I can't tell you and answer your question. I beg your pardon.

Answer by **Mehdi Ennebati – Bank of America**:

No problem. I will follow-up with Investor Relations.

Question by **Raphael Dubois – Societe Generale**:

Well, first, let me tell you Rainer, how much I enjoyed our interactions over the years, first as an investor and then as a sell-side analyst. So, it is going to be a "viel Glück für die Zukunft". And now maybe back to my question. You had some temporary hedging effects, negative ones in Q2, EUR 92 million if I'm not mistaken. It would be great if you could tell us a bit more what happened there and why is it booked into the special item category and not into business as usual?

Answer by **Reinhard Florey**:

First of all, I think we have to differentiate between the realized and the non-realized part of our hedging that we have in our accounting. In terms of the realized hedges, we have in the second quarter some EUR 72 million. Most part of that is coming still from

oil hedging, which has ended by end of June. So, there is no oil hedge in the Group for the second half. It is only a small part coming from gas here. Now for the special items booking – these are mainly the non-realized gas hedges. In addition, as we don't have oil hedges anymore, part of the oil hedges which were booked as unrealized in Q1, have been realized in Q2 and therewith lead to a positive impact in the special items in Q2. We have in total a special item of some close to EUR 90 million from hedging, and that is more or less the effect of our hedges for Q3, Q4 and partly Q1 of next year that we have in gas that Rainer has described already. However, that is of course only the accounting effect because we have to take it as a mark-to-market valuation from exactly the forward level by the end of the second quarter. So, this will then be revised and calibrated into the realized hedging results that you will see quarter-by-quarter.

Production outlook

Question by **Michael Alford – Citi**:

Good morning, Rainer. I also echo others by saying wish you the best in the future. On the upstream maintenance in Q3 could you just maybe give a little bit more granularity as to how long the maintenance will be in Russia and therefore the kind of targeted production in Q3 from that region?

Answer by **Rainer Seele**:

Michael, thanks for the best wishes. The same to you. So, let's talk about upstream business now, maintenance season. I think it will be a few weeks of interruption of gas production in Russia. Two to three weeks we have planned for the maintenance shutdown. And then as you might remember, I have said that we are going to upgrade also the compressor station and therefore we are back to a higher pressure in the gas system so that after the maintenance season, we are back to 100,000 barrels per day contribution in Q3. So, just to make the math a bit easier. If you take Q3 and the maintenance, let's say round numbers, it's one month, then you have to calculate in this quarter two months of gas production from Yuzhno with a little bit drop on top as a good vodka. So, that's the way I would do it.

Refining & Marketing

ADNOC Refining

Question by **Henri Patricot – UBS**:

A couple of quick questions on ADNOC Refining, the issue with the RFCC unit, has that been fully fixed now? And secondly, is this a typical quarter in terms of the contribution from trading in the second quarter, or you still kind of prepping up these operations?

Answer by **Rainer Seele**:

Talking about ADNOC Refining, the RFCC plant is back in operation. We don't have problems to restart the plant and with the catalyst like the first time. This time we only had to fight against corrosion. So therefore, I don't want to say it was easier done, but it was not the same kind of problem we had to solve like the first time. I do hope that this FCC plant will now reliably run into the second half with the contribution. As we speak about the trading activities positively contributing to the overall performance of ADNOC Refining, I clearly have to say, this can't be the future model. We need to see an improving margin in ADNOC Refining to come up with more convincing numbers. And the question is, of course, how do we see the refining margins in the second half of this year. And then this will be more or less the main factor determining the quarterly contribution from ADNOC Refining.

Gas result

Question by **Josh Stone – Barclays**:

On the downstream gas business, you have lower earnings. You mentioned storage was particularly weak. I wonder if you could maybe just give a bit more information on why and to what extent you're seeing things can recover in the second half of the year?

Answer by **Rainer Seele**:

When we talk about the gas business, well, we have two main effects. On the one hand side, I think a major part from the storage business is not in 2021 in as a contribution to the overall performance. There is not a summer-winter spread existing, just look into the numbers. Nowadays, you are paying EUR 36/MWh and the forward price, if you are lucky, you can get a 30. So, what kind of business is it? So, you better keep the gas in the storage and I'm not very much optimistic for the summer-winter spread because you have to load your storage with high priced gas in summer. You have to bring in the EUR 36/MWh and you have to pray that the EUR 36/MWh is coming back in the winter quarters. So, that's what I have to give as a farewell message to the storage operators. It's not big fun in storage. This is the transformation what I have said. The second part is that the power business in Romania was contributing less and the question is what is going to be the spark spread. The spark spread between running our gas-fired power plant is also pretty difficult because now we are talking about the price delta of natural gas to power. But the message is not the same as in storages. I think that the spark spread has a good chance to come back in the second half of this year.

Nord Stream 2

Question by **Michael Alsford – Citi**:

I couldn't let you go without asking a question about Nord Stream 2. So, given the recent developments, I was just wondering whether you could remind us of how and the timing of when OMV will get the financing back that they've provided for the project. If I remember correctly, it was just over EUR 700 million, so maybe you could explain that would be great.

Answer by **Rainer Seele**:

I am delighted to talk about Nord Stream 2 of course. Well, while we talk about the timing, I refer to the CEO, Matthias Warnig, explaining us that he is expecting that construction will be finished end of August. So, beginning of September, I think the procedure of certifying the pipeline to be ready for gas in, we are going to see first gas running into the pipe hopefully in the second half of this year. Reinhard explained already in a press conference today that he is expecting that we are going to get first cash payments from Nord Stream 2 company in the second half of this year. We are going to tell you that cash is coming back, starting already with the second half of this year, and I would say it's not only the EUR 729 million, which I would like to have back, Michael, it's also the interest rate on top of the EUR 729 million. So, it's really more than EUR 729 million. I can see Reinhard smiling just on the opposite of the table here because he has an idea how much it is. So, it's more than this.

Chemicals & Materials

Chemical margins

Question by **Raphael Dubois – Societe Generale**:

On the chemical business, your guidance for the rest of the year in terms of margins is pretty wide. Can you maybe tell us a bit more about the third quarter for which you should have a good visibility? You talk about margins reverting to a more normal pattern. How fast is this normalization happening and what sort of margins you think could be achieved for the commodity part of your business? And still related to chemicals the specialty part of your business, I guess, there will be some resets at contracts. Could we expect a rebasing at a higher margin to somewhat reflect the strong environment we are in?

Answer by **Rainer Seele**:

Raphael, I'm delighted to talk about chemicals. Well, first of all, I will talk about two different margins. The polymer margins more or less reflect the main business of Borealis and let me call it the basic chemicals margins, which reflects more or less the monomers, ethylene and propylene. So, what we see is that in polymers, we have seen the peak of high margins in the second quarter. We don't expect to see the same margins in the third quarter. If I look into the pricing in July, beginning of the third quarter as an indication, we do see already price reductions, especially in polyethylene, the effect on polypropylene is a bit less. So, that's why I think we have to prepare for Q3 where the polymer margins are decreased, but I have to say, not brutally decreased. So, it will be a smile on the face for Alfred to present the Q3 numbers in polymers as well. Therefore, don't be too drastic in your expectations. The polymer margins were twice as high in Q2. So, there is a 100% room left to come back to what you have said the normal level of margins and I wouldn't expect that the margins will half on Q2 into Q3. When we talk about the basic chemicals margins, it's more depending on the development of the feedstock prices. So far, we have seen naphtha prices coming up to a level we haven't expected. I think we have seen USD 690/ton. So, naphtha increase was pretty high. On the one hand side you enjoyed as a refiner, on the other hand side, you are starting to not have a smile on the face as a chemicals producer. This was the effect, so it's depending how naphtha prices will move into Q3, more or less determining the margin performance in ethylene and propylene. What we have seen is that increasing naphtha prices could be hand over at least partially to the customers also in July. My indication is the basic chemicals margins, as we talk mainly about ethylene propylene, the margins are not heavily reduced in the third quarter so far. All in all, I would say Alfred and the OMV Board will enjoy having fun in chemicals in second half of 2021. What I would say in specialties, what I can advise you, yes, there is a premium. But I would advise you to see that premium more as a constant number and not as an increasing number as we speak about looking down the road.

Inventory effects

Question by **Henri Patricot – UBS**:

Wanted to follow-up on the comments on the evolution in the second half. I wanted to have a bit of sense also the magnitude of the inventory gains in the second quarter and whether we should expect these to reverse in the third quarter, just based on latest prices that you're seeing?

Answer by **Reinhard Florey**:

Henri, regarding the magnitude of inventory effect in chemicals, it's around EUR 50 million for this quarter and we are expecting that more or less to reverse. We are expecting that the level of inventories will not be higher, both in terms of valuation, as well as in terms of volume and therefore we would not see such effect coming in the third quarter or in the fourth quarter again.

Circular economy

Question by **Josh Stone – Barclays:**

On the Bornewables products you've launched. Are you able to say how much more expensive it is to source renewable feedstock versus traditional feedstock and I think you mentioned a premium product? Are you getting price premiums on these greener polyolefins? In other words, are they margin enhancing or they margin diluting?

Answer by **Rainer Seele:**

Well, Bornewables come with a premium in the price. How much it is? We would like to keep as a secret. But all I can confirm is it is not margin dilution what we have in our plans. It adds value to the overall performance.

Fertilizer business

Question by **Mehdi Ennebati – Bank of America:**

Regarding the fertilizer unit disposal. Could you update us please a little bit more and tell us if we should expect the disposal announcement in the second half of this year? And maybe can you be a little bit more precise please regarding the profitability? Because you said during the call that year-on-year, the profitability of the fertilizer unit was more or less the same, slightly better, but you also said that the current macroeconomic environment is positive for the selling of that unit. So, maybe can you just tell us if you expect a higher profitability this year from that unit compared to last year, or is the natural gas price so high that it is -- may get to be impacting the profitability of that unit?

Answer by **Rainer Seele:**

Regarding the disposal of the fertilizer business, yes, we are according to plan and we would like to sign a deal if satisfying offers will be received in the second half of this year, so, until year end. There is no reason to change our timeline, the process has started and I think we are now moving into a phase that first non-binding offers are coming in. But it's now too early to give you any kind of an indication. All I can say is maybe the timeline is set and we are according to plan. When we talk about the market environment, yes, if you look into fertilizer business, you have seen some price increases and margin improvement. We must wait and see how this will further develop in the second half, because what I have explained is that especially, the feedstock prices for fertilizers went up enormously. As a gas producer, I of course enjoyed the EUR 36-37/MWh. As a fertilizer producer, I really have to take a deep breath to pass this feedstock price increase to the customers. So, we have to wait and see. So far, I would say the business environment for fertilizers in the first half improved, if we compare it with last year.

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