OMV Q1 2022 Conference Call – Q&A Transcript

April 29, 2022

OMV published its results for Q1 2022 on April 29, 2022. 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.

OMV Group

Outlook

Question by **Sasikanth Chilukuru – Morgan Stanley**:
The first was related to the increase in your guidance for realized gas prices to EUR 45/MWh. I was just wondering if it was possible to isolate the effect of excluding Russia in this guidance, how much that specifically has added to this increase in realized gas prices. And related to this, if you can talk about your outlook for gas prices, for 80% of your gas portfolio which is exposed to the local markets, what are you seeing in those markets in terms of the prices where they stand and your expectations over the next three quarters?

Answer by **Reinhard Florey**:
The main effect why realized gas prices will go up, also in second quarter, will be that there is no hedge effect on gas prices anymore regarding European hub-related gas prices. We still had in the first quarter of 2022 a remainder of the gas hedges, which we don't have any more in place from second quarter onwards.

Now, the Russian gas price as we receive it has always two different levels. One is 50% based on the BAFA price, which is the European export price, and 50% is based on the domestic price. Now, as we have deconsolidated and are not expecting any cash to be seen in our numbers going ahead, we will also not look into the valuation of Russian gas prices from the volumes that Yuzhno may still deliver. Which means that this is rather a balanced impact, because if we have 50% of higher European prices and 50% of lower domestic prices, we believe that does not have a significant impact on the change. So, the major impact on the change will rather be how our other international gas prices develop, be it in Malaysia, in New Zealand, or in Tunisia. And of course, the impact of the European hub-based prices now with all the limitations from hedges falling away.

Question by **Matt Lofting – JP Morgan**:
On gas and the EUR 45/MWh assumption for the full year, I know there's a blend of price regimes and inputs within the average. Could you just tell us what you're assuming on European TTF gas pricing for the rest of the year within that 45?

Answer by **Reinhard Florey**:
Regarding gas price development in Europe, that's of course a tough one. There is a belief that we have that there will be a continuity in supply, also from Russia. And there is also a belief that there will be moderate measures to slightly reduce the demand in Europe. That leads us to an assumption that overall, we will not see the same high level of gas prices like in the first quarter, but only slightly reducing. So, this means, if we look at THE or a CEGH hub level, where we have seen prices in average above EUR 100/MWh in the first quarter, we will see that over the year this goes below EUR 100/MWh, but still on a relatively high level. But this, as I said, is a base assumption and there is all this volatility due to decisions of a political nature. That is something very hard to predict.

Russia related

Question by **Henri Patricot – UBS**:
On the gas imports from Russia and what's your latest expectation on your ability to keep paying for the gas or you see the new payment mechanism working out? And what's the planning if for some reason you're no longer able to import Russian gas in the near future?

Answer by **Alfred Stern**:
I think it's important to separate two things, one is the actual gas production and the other one is the gas imports into Austria or Germany. I think the description about the production in Yuzhno Russkoye was described by Reinhard, so I won't go there again. But concerning the gas imports, what we have done in OMV is we have immediately triggered a gas task force that is looking at the situation on an ongoing basis and putting measures in place to mitigate the risks.
And what I can say here at this point is that up until today the gas supplies from Gazprom continued to flow according to our nominations and according to the contract that we have. We also have up until this point paid in euros, but we have received requests from Gazprom to change the payment method, which we have analyzed. And we are currently working on developing a solution how we could go forward in a sanction compatible way. And this I want to make clear, whatever we do, we will make sure to comply with any sanctions or any regulatory requirements.

Question by **Henri Patricot – UBS:**
One quick one just in terms of the timing and when the next payment to Gazprom is due.

Answer by **Alfred Stern**:
Next payment is due in May.

Question by **Bertrand Hodee – Kepler Cheuvreux:**
I know it's a difficult one, but there are a lot of worries in the market about the financial risk, if Gazprom gas supply were to stop. Have you already committed to sell some of this gas to third parties on a forward basis? Will you be able to call for force majeure if supplies stop? And so, can you give us any color about the potential mismatch between your already agreed cost of supply and your deliveries on a forward basis? So, any color on that kind of risk would be helpful.

Answer by **Reinhard Florey**:
First of all, we are committed to, as far as possible, to keep this supply up, but always only under the condition that we can do that in accordance with any kind of sanction law of European sanctions. So, if there is not a possibility for that, then of course we will not be able to do that.
Regarding any commitment to sell already forward, there is a situation where we have a month ahead booking. So, of course, there is then also month ahead pricing and month ahead hedging with all that. But then, for instance, if we take gas from the market to also put it in storage, of course, everything that we put in storage we have already sold, and we have sold it forward to a Q4 or a Q1 or so. This means we are not taking any kind of risk in the way that we are putting the gas into the storage and exposing ourselves to the risk of higher or lower prices when we take it out again. So in that sense, there's a limited risk position other than maybe regarding month ahead hedging.
If you're talking about force majeure, of course, interruption of gas supply is a force majeure, whether it comes from one side or the other side, for us it is force majeure and for our customers, unfortunately, then it also will be force majeure. But this is something that of course needs to be taken into account, in which speed such force majeure declarations can be taken, and of course that limits significantly our risk.

Question by **Bertrand Hodee – Kepler Cheuvreux:**
Can you disclose the contribution from Russia in Q1 at the operating level or cash flow?

Answer by **Reinhard Florey**:
The contribution has been restricted to only two months and we are not disclosing separately what is the inflow there. But you can imagine that this has not been very significant in terms of the results side. As of course there's also a tax payment related with that. But we are now very cautious in terms of any kind of assumptions on what we would receive in the future. And therefore, you can assume that on the way forward we will, for the reason of deconsolidation, not have any results anymore included in the operating results or in the cash flows that we show.

Question by **Raphael Dubois – Societe Generale**:
And speaking of Yuzhno Russkoye, can you tell us if you have any update on the dividend that you are supposed to receive in August? Should we count on it or not?

Answer by **Reinhard Florey**:
We do not have an update these days because the reliability and the predictability of what can come as dividend streams from Russia is very opaque. There are some regulations in place that would even prevent some cash flowing from Russia to outside shareholders. In fact, Gazprom will have to sort out a way to pay it out. Because from the mechanism, otherwise it has to stay in the Yuzhno Russkoye company and cannot even be transferred out to Gazprom. So therefore, we trust that there will be a discussion on that. But to be very frank, I'm not counting on it in my cash flow expectations in 2022, because there's too much uncertainty.

Shareholder return

Question by **Michele Della Vigna – Goldman Sachs**:
On your cash return to shareholders. You are clearly generating exceptional free cash flow. You will soon be almost without debt. I was wondering, how can you think about incremental return to shareholders? Would a special dividend be the best way to do it? Are buybacks potentially doable, given your current shareholder structure or is that impossible to do? How would you think about that given that the environment is proving to be very generous to you, and you have a very cash flow generative business?

Answer by **Reinhard Florey**:
Michele, your observations about the strength of OMV's balance sheet and about the cash flows are absolutely correct. And of course, we are very proud of that. We have already at the end of 2021 said that we have in our capital allocation a very clear focus also on returning value to our shareholders. And we have expressed that in our progressive dividend policy with a big hike of a dividend that we will pay out in Q2.
We are currently not in the position to discuss any kind of buybacks for the known reasons of our shareholder structure. However, I would also like to point out three things. The first is, we are living in times of uncertainty. So, it is also not unreasonable that a company also looks for a strong balance sheet. The second is that, of course, with the strategic growth opportunities that we are currently looking into with our new strategy, this is something that should also, on the mid- to long-term, yield very good profitability and cash flow growth for the company. And thirdly, as I also said some months ago, at the moment there is the progressive dividend policy in place. I'm not promising anything more, but I'm also not excluding things.

Chemicals & Materials

Borealis dividend policy

Question by **Sasikanth Chilukuru – Morgan Stanley**:
Now that there's a change in the ownership, should we expect any change in the dividend policy of Borealis? You've paid EUR 175 mn this quarter, I am just wondering if you can provide some context to that, whether this is an annual dividend or should we expect more payments in the remaining three quarters.

Answer by **Alfred Stern**:
Let me maybe just start by saying that we are very excited about this development. Because as you know, the Borouge joint venture is a very important growth vehicle, in particular with Borouge 4. And there we are looking back at the long-standing partnership with ADNOC, not just around this Borouge JV but also at a partnership in refining and in upstream together with them. And we think this strengthens this partnership and will provide a good framework for the joint way forward together. As it relates to the dividend policy, we have not agreed any changes. And therefore, at this point the dividend policy will remain the same.

Question by **Sasikanth Chilukuru – Morgan Stanley**:
Just to follow-up on that. The EUR 175 mn, is that an annual payment or is it a quarterly payment? And should we expect more in the next three quarters?

Answer by **Reinhard Florey**:
The payments of Borealis dividends are twice a year, and we will potentially expect a dividend later in this year. But this of course is depending on the discussions that we'll have with the new 25% shareholder if there is a dividend in the second half.

Chemical margins

Question by **Mehdi Ennebati – Bank of America**:
Regarding the chemical margin. So clearly you surprised positively this quarter, thanks to very resilient chemicals margin in Europe. Can you tell us why polymer prices remain that strong currently in Europe? Is there any change regarding the polymer demand in Europe? Is the polymer demand reacting to such high polymer prices? And if not, why? Is it still because you are benefiting from some global supply chain disruption, which makes the polymer supply in Europe relatively low? And why should we expect those global supply chain disruptions to disappear?

Answer by **Alfred Stern**:
We do see continued good demand for polyolefins and for olefins in the market. And what we also see is higher but still limited imports coming to Europe. And under these market demand conditions it was actually possible to pass on the significant cost increases and drive the margins further. That's one part. And we have seen that now also in the beginning of April, in particular for the ethylene and propylene prices, that we were able to significantly push this, while naphtha drops down a little bit. So, continued strong demand in this market that is wishing to be supplied.

And on the polymer margins, also here we saw a significant price increase now also in the beginning of April with continued strong demand and limited imports. As you probably know also, there are still globally quite a number of containers that are somewhere stuck on ships and not moving around. There was a slight improvement of that situation in the beginning of the year, but it's gotten worse again now in the last couple of years, partly connected also to these COVID outbreaks in Asia again. So that's one part that there's demand and the supply demand balance allows to pass on prices.

The second piece that I do want to mention is that, of course, these are indicator margins that we always talk about. But our business is then driven by the realized margins that we make. And here we can benefit from a relatively high specialty percentage, 40% of our volumes are specialty connected that in average have about double the margins of the other business. And this is a stabilizing factor. We saw good demand into those specialty areas. So, this is allowing these chemical margins and the chemical business, in particular the polyolefin business, to perform strongly in the first quarter.

Question by **Matt Lofting – JP Morgan**:
Coming back to the earlier comments on chemicals and materials, it sounded like the outperformance in realizations and margins through the specialty side of the business was an important lever in the quarter. Could you just talk a bit more about that in terms of some of the key market opportunities that you saw? And the extent to which you think that those stronger specialty margins are sustainable when we look forward through the rest of the year versus transitory around Q1, particularly given that I think from an outlook perspective for your headline polyolefin benchmark guidance hasn't changed for the full year?

Answer by **Alfred Stern**:
So, Chemicals & Materials on the specialty business. When you look at that, about 40% of our polyolefin sales goes into specialty segments. And the big specialty segment that we have there is really around infrastructure, of which a big part is wire and cable insulation, and some other parts also into some specialty pipe applications and so on.
In this business area we have seen good demand, and demand growth that is also driven from investment activity into renewable energy generation and into improving the electricity grid across the globe, but also in Europe. We see that this will continue to be a strong trend. You may be aware of one of those very big investment projects in Germany where they are making those three energy corridors going from the North to the South of Germany for underground electricity cables. That's what you have to imagine there.
What we also see is continued good demand into the areas of healthcare and advanced polymers, were the growth from developing the business but also underlying demand growth is there.
And the last piece I want to take here is the automotive business, which is one of those specialty areas as well. And there it is maybe a little bit less clear how it will go forward because we have seen last year these supply limitations from the lack of microchips. We saw that there were some improvements regarding this in the last couple of months, but now there has been another setback due to the Ukraine crisis. But we will see how this performs going forward. But overall, good market areas with growth. On the pricing situation there, this will eventually see some pricing pressure. But the pricing mechanism there is such that it will be significantly more stable than what you see in those indicator margins.

Question by **Mehdi Ennebati – Bank of America**:
Regarding the chemicals business. So, from what I understood, April is starting quite well. Is it fair to consider that so far, your realized chemical margins in Q2 are above the first quarter given the current market?

Answer by **Alfred Stern**:
On the chemical margins, yes, the way I would describe this now in the second quarter is that it started extremely strong, still good demand and some limited supply. And what happened there is that the prices actually went up significantly, ethylene over EUR 200 and also propylene over EUR 200 price increase. And at the same time, we saw a reduction in naphtha prices, so we'll see margin expansion coming from this. And of course, that will be beneficial to our result.

Borouge

Question by **Raphael Dubois – Societe Generale**:
Can you maybe tell us a bit more about how the quarter has started for Borouge sales? Having in mind that it's very Asia-oriented. I would like to know if the current COVID restrictions in China are having any decremental effects on your business lines?

Answer by **Alfred Stern**:
When you look at the Asian business that we export into with Borouge, then what we have seen in the last couple of months is a slowly rising price environment over the month. But let's say prices going up, but less fast than one could have expected with the increase in naphtha prices in raw material cost in other words. So increasing price environment, and that is driven by some of these issues that you talked about, some of the constraints around the demand driven by COVID, but also some additional capacities. However, we did get price increases versus Q4/21, both in polyethylene and in polypropylene prices more or less at the level of last year. And with this, since we have ethane as a feedstock, we could benefit from a slight margin expansion.

Question by **Raphael Dubois – Societe Generale**:
On Borouge. In Q4 you received a very large special dividend. In Q1 you injected some money into Borouge for the Borouge 4 expansion. So, what should we expect in terms of financial flows between Borealis and Borouge for the rest of the year?

Answer by **Reinhard Florey**:
You are right, in Q4 we received a large special dividend, and this special dividend was to a certain degree earmarked also as money to be injected as equity for the Borouge 4 development. Not all of it though. Therefore, I'm expecting two things for the rest of the year. First of all, I'm expecting from Borouge as a company, continuing dividends. But I'm also expecting that for Borouge 4, there will be again equity injections necessary to the certain degree that the financing is required from the shareholders and cannot be more or less leveraged from the market.
The company has leveraged itself, which leads to this large payout in Q4. So, I think there is limited additional possibility to further leverage the company. And therefore, I am expecting more or less a balance between what can be paid out as additional dividends, because it's still a very well operating company with a good cashflow. But on the other hand, of course, also the payout and the Capex for Borouge 4starts now. So, I would say it's probably a balanced view with a slight bias to some cash inflow for OMV respectively Borealis from that.

Fertilizer business

Question by **Mehdi Ennebati – Bank of America**:
About the fertilizer business. So, clearly you said it started doing extremely well because Russia is disappearing from this market, making it quite interesting, and even strategic right now. So, do you still intend to sell that business or not anymore?

Answer by **Alfred Stern**:
You are absolutely correct, the fertilizer prices have climbed to a really significant level. If you remember, last year the fertilizer market and business was struggling significantly with the fast increase in gas prices, and there was a strong margin squeeze. So from the end of last year, it was then possible to pass on those price increases. Partly this is driven again by stronger demand. We see an effort also in the Western part of Europe to increase agricultural production to compensate some of the anticipated falling away of exports from Ukraine and Russia, but also lack of fertilizer exports from Russia. And those two things together have led to a strong demand supply imbalance that has then allowed to really pass on the gas cost increases, but even expand the margins significantly.

As to the strategic direction for OMV and Borealis, here we are quite clear that we will keep the fertilizer business as an asset held for sale. And we will continue on our strategic pathway to move into more and more specialty polyolefins and a circular business model.

Refining & Marketing

Refining margins

Question by **Joshua Stone - Barclays**:
Just a question on refining. Clearly distillate prices have been extremely strong. Is OMV seeing that? And how much of that are you able to capture? Maybe could you give us some indication of how refining margins have been trending in the last several weeks? And how much of that you're able to capture?

Answer by **Alfred Stern**:
So just that you get a bit of a feel for this. If you look at refining indicator margins for Europe, last quarter last year was already quite high with about USD 6.3/bbl. And January and February we started slightly below that level. But then in March what we saw is a steep increase going up to about USD 17/bbl. And that made for that strong refining indicator margin for the first quarter of about USD 9.8/bbl.

And what we have further seen, and this is really driven by multiple things in my opinion. One is, there's supply-demand imbalance. You probably know that Europe imports quite a lot of oil products, so not just oil but oil products from Russia, in particular diesel and middle distillates heating oil and the like. And these imports were reduced while consumers, for example, in heating oil showed sort of early buying behavior for heating oil and things like this.
So in April, we then saw further increases in the indicator margins, but I have to say this is really a quite volatile situation that is driven by multiple factors. And this is difficult to predict. That's why we are saying we anticipate it will be significantly higher than our previous guidance of USD 4.2/bbl. The second half of the year is even further away. But as I said, the second quarter has started extremely strong.

Question by **Mehdi Ennebati – Bank of America**:
So you have a refining margin indicator. Can you please tell us what is the current level of that refining margin indicator, knowing that in the first quarter it was USD 9.8/bbl. I understand that you are doing maintenance at Schwechat, meaning that you are not able to capture all of it. But just wanted to have an idea about the level.

Answer by **Alfred Stern**:
On the refining indicator margins, I would agree with you. As I described, beginning of the year - January, February was strong, and

then in March we had a significant expansion of these margins. And now in April they have increased even more. And we are seen refining indicator margins for Europe now for April of around USD 30/bbl.

Middle distillate hedges

Question by **Joshua Stone - Barclays**:
You've often been quite active on hedging middle distillates. I presume today there's not enough liquidity on the curve to do that, but maybe if you could make a few comments about any hedging activity?

Answer by **Reinhard Florey**:
Still in 2021 we had quite some hedges in place which contributed to a low double-digit million number each quarter. And this was also in the continuation of the year 2020 when many of these hedges were put in place because of the disruptions of the market.

Now in this year, the benefits from hedges will be much, much lower, because there is of course much less liquidity and much less of these hedges in place. This does not mean that we exclude that some hedges could be taken from an operational point of view again in the future. But at the moment, we have very little exposure here. And also, the impact, positive or negative, will be insignificant for the year 2022 going ahead.

Retail margins

Question by **Michele Della Vigna – Goldman Sachs**:
On your market margins. We're seeing a lot of pressure from governments in Europe to try to contain prices to the consumer. Do you see that potentially impacting your market margins in Q2? Or you think that is manageable with stable margins as we've seen historically?

Answer by **Alfred Stern**:
On the margin situation, what we are seeing is what I believe you are referencing to. If you look at the retail margins that we were able to achieve in the first quarter, the reduced result in our retail business is really because of a squeeze in retail margins.
That's coming from two different things, one is around the fast-rising fuel cost that couldn't be passed on fast enough. But the other piece is from some of the countries where we also supply that there are fuel caps in place reducing our capability to pass on some of those things. Of course, we are optimizing that, but there is increasing pressure from consumers around these topics.
I believe here in Austria where we have a significant market for this, the Austrian government has chosen a different path. And they are providing support to lower-income families, not through price caps, but through subsidy support. I believe that is a very smart way because we see in all those countries where they put price caps, the markets become less dependable and there's partly irrational behavior then going on. So, some of the discussions we will maintain, but the basic situation that we have supply constraints will not go away, that will allow to pass on some of the prices.

Exploration & Production

Production outlook

Question by **Raphael Dubois – Societe Generale**:
My question is on your upstream production. With Russia now deconsolidated, you are already at your 2030 upstream production target of less than 400 kboe/d. I would have expected that maybe you review your upstream production path in line with the Russian deconsolidation. What should we expect? Should we rebase your expectations you gave us earlier this year with a decrease in the Russian production? Or will you adjust differently the long-term strategy?

Answer by **Alfred Stern**:
In the strategy we had Yuzhno Russkoye in as you said. And we had Yuzhno Russkoye in with about 100 kboe/d in 2021, with 80 kboe/d for 2025, and with 40 kboe/d in 2030. So basically, the revised targets that we are using now as a consequence from this deconsolidation is for this year 390 kboe/d, and then going forward for 2025 370 kboe/d, and for 2030 350 kboe/d.

Neptun

Question by **Raphael Dubois – Societe Generale**:
On Romania, I understand that new tax terms for offshore gas are circulating, they might still be modified. But from what you have seen so far, can you share with us how they look like compared to what they were prior and against your expectations for an FID of Neptun?

Answer by **Alfred Stern**:
OMV Petrom has been working long and hard on this very important Neptun project. But we can only make an FID for this project when we have an offshore law that is amended and approved by the government there. This is still not the case. It's correct what you said, that there seems to be some movement, and a proposal was submitted to the parliament there for reading. And we will then see what the further progress is.

This is a great step, we are very excited about it because this is a good and interesting project, and we would be happy to take an FID on it. However, we need that offshore law approved before we can do so. And since there have been so many delays, I will wait until I have the final confirmation of approval before I celebrate.