OMV Q2 2022 Conference Call – Q&A Transcript

July 28, 2022

OMV published its results for Q2 2022 on July 28, 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 **Mehdi Ennebati – Bank of America**:
Can you maybe explain to us why, what are the results you know of the decrease in the polymer margins polypropylene margin that you are expecting in the second half. While at the same time the monomer margins you know remain quite resilient, if I am not mistaken. So it would be good also to have your view here.

Answer by **Alfred Stern**:
On chemicals, on polypropylene specifically, as you point out, we have taken down the guidance for the full year to the 500 EUR/t for the rest of the year. Before I explain it, I want to make sure to point out that we are talking here about the standard polypropylene margins that you have in the market. When you look at this margin development and look for example at the Q2 result, you can see that our business is much more resilient to those moves because we have 40% of specialty contribution here with a higher margin contribution that does not follow exactly these things. But on the standard polymer on this indicator margin, why do we believe it has come under pressure? It is so that we see certain headwinds for the demand situation and at the same time improvement in the logistics situation that we see some more imports coming into Europe with the polypropylene also. I do want to point out that we have at the same time now also increased our indicator margins for ethylene and propylene which are import materials, import cost into making polypropylene. So, we think there is a bit of a pricing shift from polypropylene into propylene. And with this we still get quite a good situation then in this integrated supply chain for the rest of the year.

Question by **Henri Patricot – UBS**:
I wanted to ask about the realized gas price guidance that you've left unchanged that 45 EUR/MWh for the year. Am I understanding that it's only part of your production that's linked to European spot prices, but we've seen a very significant increase in prices recently. So why did you decide to leave that guidance unchanged?

Answer by **Reinhard Florey**:
If we are looking at the realized gas price you have seen a strong hike between Q1 and Q2. The main reason actually was that the Russian volumes were deconsolidated. And therefore a relatively low realized gas price that was in Russia, partly from the BAFA price, but also 50% Russian domestic price, which is very low, falling away, that has increased in average very much the realized gas price. Now looking ahead, this realized gas price is anticipated to be a little bit lower in the coming quarters. And the reason for that actually is a positive one that we have more volumes from Malaysia and more volumes from New Zealand compared to Q2, but both are in regulated price environments, and not in the European hub price environments, so the average of the realized gas price will slightly decrease, but the volumes will go up.

Tax rate

Question by **Peter Low – Redburn**:
The reduction in the effective tax rate quarter-on-quarter was a bit greater than I expected. Can you just give any guidance on how you expect that to evolve through the second half of the year? Thanks.

Answer by **Reinhard Florey**:
Indeed, we came out with a lower tax rate in Q2 than compared to Q1. In principle, there are three major reasons for that. The first is, if you compared our results, Q1 versus Q2, in Q2, we have a clearly higher share of R&M and also chemicals in there, which traditionally have lower tax rates than the E&P business. The second is that in R&M we of course have also a higher result because of better results of ADNOC Refining. And in ADNOC Refining as this is in minority share, this is already fully taxed as we get it and as we show it. So there is no tax on that. So in in average then your tax rate also goes down and then specifically on E&P, if you look at where the volumes have been coming in Q2 versus Q1, there have been significantly lower volumes from Libya, and we all know Libya is a high tax country and more from Romania at this is comparatively lower. So those are the key topics maybe still one

comment that the tax rate that we are showing of course is totally detached from the tax payment that we are showing. So, the tax rate shows the tax liabilities and not the tax payments because as Alfred has mentioned that we paid more tax in Norway. Yes, because the tax schedules which we are undergoing in each of the countries of course give us a schedule on what we pay when, but the total liabilities we show in the tax rate. So this is, I would say, independent of what we have to, in a certain period, pay the relevant tax rate.

Cash flows

Question by **Raphael Dubois – Societe Generale**:
On the significant cash inflows we expect in the second part of the year. You mentioned you expect to close the transactions for nitrogen and the Slovenian filling stations. Can you maybe say whether we should expect further loan repayment from Baystar and also any dividends may be to be received from ADNOC Refining and Trading now that it starts to contribute nicely to your results?

Answer by **Reinhard Florey**:
Regarding the transactions of Nitro and Slovenia, indeed we are planning that those go ahead as planned. The Nitro business we certainly expect until end of this year. Slovenia, we actually also expect, but we are a little bit reliant there on what the European Commission with their anti-trust regulation will actually move forward. So, this is something which we cannot fully commit at the moment, but Nitro looks very good. But Slovenia, although we don't see an execution risk at the moment, maybe a little bit of a risk of timing.

Regarding other areas. Dividends from of from ADNOC Refining, actually, according to the dividend schedule, there is some dividends actually planned, of course, we are only a minority shareholder, so we are not fully in charge and in control of the dividends as such, but this is something, at least where we see also an opportunity as situation has improved. And regarding the second part of the Baystar loan. This is something we are actually looking into very much, how the situation of external financing is developing. We are seeing that interest rates are rising, which is to have seen another significant Fed interest rate. So, this is something that we are quite flexible on and to be honest that is a face value of gaining some cash. But indeed, the liability just changes from internal to external. I would not see that is something where we have a lot to change if we are moving along the schedule here.

Chemicals & Materials

Inventory effects

Question by **Raphael Dubois – Societe Generale**:
On the inventory effect in the Chemicals and Materials, could you please tell us how much it was this quarter?

Answer by **Reinhard Florey**:
There was a positive inventory effect in in Chemicals in the second quarter. It's in the range of some EUR 50 mn and we are expecting that this falls away in Q3, because we are not expecting that the prices are going up further. This is something where we have to adjust and in the expectations.

Borouge

Question by **Raphael Dubois – Societe Generale**:
On PP5 at Borouge. Can you just say where you are in the ramp-up process of this unit, because when I look at your quarterly for polypropylene JV volumes. It's still roughly what it was in 2020. So, I'd just like to understand when do we see a step up in volumes on that line.

Answer by **Alfred Stern**:
On PP5 we were actually able to start up the plant and ramp it up to the full production. What we observed at the same time in the second quarter was some curtailments of propylene supplies from the refinery in ADNOC. We expect this to improve on the way forward and with this also to then see the volume increase.

Baystar

Question by **Mehdi Ennebati – Bank of America**:
On Baystar you started the steam cracker, you will start the polyethylene plant this year. And you have been highlighting quite several times that this is you know a new technology, et cetera. Should we expect pretty high margin, let's say top range margin from Baystar relative to your other chemical assets? And should we consider that most of Baystar polymer production will be kind of a specialty chemical, meaning that you will have, you know, fixed margin just for me to try to model that.

Answer by **Alfred Stern**:
The Baystar joint venture started off with about 400,000 tonnes of polyethylene capacity that was not integrated. The project that we had was to build a cracker for one million tonnes of ethylene and a Borstar polyethylene plant for 625,000 tonnes of polyethylene, Borstar polyethylene. With this, it then becomes a fully integrated 1 million tonne complex that will produce polyethylene. They are based on ethane. Ethane from US sources. Now the first step we have now succeeded in the beginning of July to start up the

cracker that is converting ethane into ethylene. While the Borstar polyethylene is not yet on stream, we are making good progress in constructing this and we are expecting that before the end of the year in the fourth quarter we will start up that Borstar polyethylene plant. In this transition period, we will be long ethylene, but we will of course start supplying the already existing 400 kt of PE capacity there. As in general, your statement that our aim is to make differentiated polyethylene products that are aimed for specialty segments such as wire and cable, for example, it's correct. However, the procedure with these very big complexes is that you have to start them up and you have to get them running at full capacity. So that this will go over a couple of months before you can come to the full capacity, but it is based on advantaged ethane from the US and the aim is to go into differentiated products there.

Refining & Marketing

Schwechat refinery incident

Question by **Henri Patricot – UBS**:
On refining in the Schwechat refinery, you're expecting reactivation on September/October, you were talking previously about the second half of the 3rd quarter. I was wonder if you could expand on what's proving a bit more challenging in terms of getting that fully back on stream, what is taking a little bit longer? And what's the risk here that it could take a bit longer than you think?

Answer by **Alfred Stern**:
The incident happened beginning of June and then immediately we put a task force in place, that is looking at multiple things. Two of the key parts that they look at is, to build up an alternative supply system and the second one to come up with a repair concept. We are making very good progress along the repair concept and the plan where we are moving forward, but as you mentioned, right, as we move forward – in the beginning of June, we did not have all the insights that we have. So, we have now become a little bit more cautious to say end of September, October, because we are now fully understanding and have a more solid plan that is allowing us to make that prediction. We believe in the start up in September/October is a realistic timeframe. Also, we were able to build that alternative supply system to ensure that we have the capability to supply the market and our customers.

Question by **Tamas Pletser – Erste Group Bank**:
I remember when you had this accident in Schwechat you received some products from the Austrian strategic reserves, can you tell us a little bit more about the situation. Did you receive from these strategic reserves more than one times these products and how do you plan or what is the obligation for you to give this product back? Would you pay for this strategic reserves or would you give it back in kind, I mean in products later on?

Answer by **Alfred Stern**:
So maybe I start with what happened and how it went and maybe if I can't cover everything on the costs, Reinhard may add. So, at the time of the accident we were at the end of multi-week turnaround, which also implied that our own storage was on the low side, and this triggered us into immediately inform the Energy Ministry in Austria about this situation and request them to make an emergency release of some quantities that are required in the market. That was also approved and released. Then at the same time as we started working on our repair concept and the alternative supply concept, we identified some weeks later that we still had some gaps in some of the product areas and through further discussions with the government here in Austria, but also discussions in surrounding countries, we came to the conclusion and that we needed some additional quantities and got also some further quantity supplied here in Austria to make sure that we can cover the required market demand and supplies. So that happened so far, and the requirement is of course that we need to replenish those quantities that we have received to ensure also that they are then in the reserves again after we get through this emergency accident here. And there we have slightly different kind of arrangements how we do that, but always there is a requirement to replenish the quantities.

Question by **Tamas Pletser – Erste Group Bank**:
And do you have a time frame for that?

Answer by **Alfred Stern**:
Yes, there is some time frame to replenish those in the months after the start up of the refinery. As you will realize that is requiring the balancing of the supply-demand situation. We cannot then not use the entire capacity just to replenish. But we will have a couple of months going forward from there.

Answer by **Reinhard Florey**:
Regarding the financial impact of that as Alfred explained, this is more or less giving back in kind. So, all what we are doing actually is when we are taking something, then we are of course buying immediately something forward in the future at that point of time in the market. So, there are some smaller effects coming from that. There maybe some small positive effects if the market is in backwardation. But this is not a major impact.

Exploration & Production

Gas supply situation

Question by **Joshua Stone - Barclays**:
Firstly, you talked about securing the gas capacity into Austria from other places with talks of reversing pipelines. Can you just talk about what are the guarantees you have that gas can actually flow or how confident are you that gas can flow if it needs to and maybe how much did you spend or how much does it cost to get this pipeline capacity?

Answer by **Alfred Stern**:
So what we did, Josh, is that we participated in an annual auction and we were successful in securing 40 terawatt hours of pipeline capacity from Germany and Italy into Austria. This is the basis for diversification of supply sources to Austria as we are a landlocked country here and it makes it possible then to also utilize Norwegian gas both from our own production, but also from supply contracts that we have with other regional producers such as Equinor in Norway and it also makes it possible to bring volume from the LNG capacities that we have on the Gate Terminal in Rotterdam. Currently we are supplying those direct customer quantities from our Gazprom contracts in this is now giving us option to secure the supply in case this Gazprom supply should be reduced or fall away. The regulatory situation may have influence on his this as you point out, if the level 3 of the security of supply regulation comes in place. There is to a degree intervention then of the governments how the gas is allocated to different sectors or customers and at this point the government would takeover this allocation and we would also of course then be released of our supply obligations.

Question by **Peter Low – Redburn**:
Yeah, the first and sorry to get back to this, which is another clarifying one just on gas and I'm just trying to better understand your exposure. And I guess that the tail risk event that there is a full Russian cut off of volumes. So, you talked about being able to use gas storage of other hubs. But that would still likely put you in a position where you're buying some gas from the spot market to fulfill your obligations. Am I thinking about that the right way and is there any way you can eliminate that exposure or risk entirely as linked to that kind of, what are the pricing you're offering to your customers at the moment? Are they fixed prices or are they linked to blind spot?

Answer by **Reinhard Florey**:
As I briefly explained, the major exposure that we have is actually this month ahead pricing situation and that has nothing to do with fixed prices or any kind of oil linked prices or something like that we don't have any of that. We have of course only spot related pricing in our contracts. So, if your question is what happens if the Russian supply is fully cut off then the, I would say, burden that we have to take, is actually the risk of hedges that we still have on the volumes that we have hedged, because we of course cannot do that on zero when there is gas still flowing that we have to buy this kind of volumes still on the market. Now it is important to see that we are trying to reduce this exposure with the anticipation that we have on curtailments, but of course it's very hard to fit that 100%, so therefore we expect that there will be some negative effect, but maybe also comparable to what I have explained for June respectively quarter two.

Question by **Raphael Dubois – Societe Generale**:
About this gas situation. Just to better understand, who is going to bear the extra cost of the gas access. I understand that you have secured the volumes, but when it comes to importing gas that will be transported via this new pipeline access presumably it would be more expensive. So, in the end will it be you, the customer, or the Austrian government that will bear the fruit of the extra cost?

Answer by **Alfred Stern**:
Now, Raphael on the additional cost for the alternative gas supplies. Maybe what I would like to comment there is that I think it will depend a little bit on the situation that we will find ourselves because some of these costs of course, you will find reflected in the hub pricing depending on where the gas flows come and what the demand is. And as Reinhard pointed out before, all our contracts, both on the sourcing, but also on the supply side are in some way hub based. But in any case, in for this particular pipeline capacities, I want to mention the diversification law that was put in effect in Austria, that was aimed to compensate for some of the additional cost for diversification of the supplies the Austrian government has approved in this diversification law, about EUR 100 mn to be assigned for the diversification of gas supply and added cost to this.

Question by **Mehdi Ennebati – Bank of America**:
Regarding what you said earlier. You said that you can fill in your contractual obligation in Austria thanks to the new let's say pipeline capacities that you have been securing, what about your German obligations, are you able to cover all of them? And also, when you say you are able to cover your obligations, is it from now on? Is it from 2023? And does this include you know your gas inventory at that current level, which is particularly high?

Answer by **Alfred Stern**:
On the gas situation, you are correct, we were talking about the 40 terawatt hours coming to Austria and the contractual obligations that we have the customers here. We do also have a German contract which is built in a similar way, so we don't have any fixed price and we don't also have any oil-linked prices, which means the exposure there is also in a similar way to the 30 day ahead as Reinhard was explaining it. We believe the situation in Austria is fundamentally different because it is a landlocked country and it does require the entry capacity into Austria, either through Germany or Italy because historically only the the entry capacities from the east were available and booked for the Gazprom contracts and that's why this was an important step for our gas business.

Question by **Mehdi Ennebati – Bank of America**:
Just to illustrate what I wanted to understand. So, imagine Russia cuts its whole gas supply to Germany, will you be able to supply your customers, your German customers with natural gas or not?

Answer by **Alfred Stern**:
So if really this is cut 100%, I'm afraid the government will need to step in and start allocating to certain segments where they want to continue operations and that would basically relieve us from our capability of doing our own allocations.

Question by **Mehdi Ennebati – Bank of America**:
Okay, thank you. And last question, is there a risk? Would you say that there is a risk or there are some discussions in the Austrian government of a gas price cap for households in Austria in case you know gas prices keep increasing just because you know gas prices hit a relatively high currently? I am asking because this is already the case in Romania and yeah and why not you know in Austria?

Answer by **Alfred Stern**:
Yeah. I think the under the current situation with the inflation and the high energy prices, I think this discussion is taking place everywhere in Europe, but also in many other places in the world and which is also understandable. I think the Austrian government here has so far chosen a different approach to find ways how to support low income or households that are coming to their limits in terms of spending and maintaining. We do not know at this point off such an idea here

Question by **Bertrand Hodee – Kepler Cheuvreux:**
On gas hedging on the months ahead. You indicated at Q2 trading update, a loss of around EUR 50 mn in Q2 to cover your months ahead exposure after gazprom curtailed volumes. Can you give us any color if you had a similar impact in July?

Answer by **Reinhard Florey**:
I cannot give you exact details, of course, Bertrand. But if you follow what has happened in July, then you see that there was again volatility. And every volatility actually is something that is then taking us off path from an expected level of hedge. So, you can expect that there is negative impact from that also in July on the gas side, but as said, we are trying to mitigate that by also having different levels of hedges, according to the anticipation of how curtailments would come.

Gas storage and working capital

Question by **Joshua Stone - Barclays**:
On the working capital build, you as well flagged, is it reasonable to think that the working capital builds again at 3Q? And maybe just lastly, where is gas storage levels, where were they at the end of the quarter and what do you think will be at the end of 3Q? Just help us on that.

Answer by **Reinhard Florey**:
If you look into the recent history, you can see that in the past four quarters, we had working capital cash outflow in each of those last four quarters. However, the biggest negative increment was in this second quarter where we had in total net working capital build-up of EUR 1.9 bn out of which around EUR 1.6 bn are attributable to the gas storage, we have built up significant levels of gas storage as Alfred said, gas storage levels of around 80%. Now, when we are looking into Q3, will that still rise? Yes, there will be additional volumes that we intend to store because the preparation for winter and the preparation for independence of the volatility and the curtailments of Russian gas deliveries are important to OMV also in serving our customers. So therefore, I'm expecting that on the E&P side, of course, very much depending on commodity prices an increase of working capital will happen. We of course will also see effects from R&M because in R&M, you can imagine that with supply that we have as an alternative supply after the damage in our Schwechat refinery, we have lowered our inventory levels and we have to bring them back up when when the refinery is up and running again. So that's the effect in both Q3 and Q4, whereas we are expecting that working capital in the Chemicals & Materials business is rather reducing. So yes, Q3 probably will be still in negative cash out on net working capital.

Question by **Mehdi Ennebati – Bank of America**:
A follow-up here on your gas inventory levels, which are now above 80%, should we consider that this could help you to get you know quite nice gas marketing business in the second half of the year if the gas price keeps increasing or did you already hedge your gas margin for that gas you currently had banked on. I am asking because the loss in your gas marketing business in the second quarter is creating a little bit of confusion here.

Answer by **Reinhard Florey**:
Regarding the gas effect, of course, whatever we put in storage in our gas business, we have already sold forward and with that also hedged. So that you can imagine that of course we are trying to also get positive results from that in the current environment, that certainly also is possible. But there is not an exposure to the volatility of gas price now to what we have stored or what we are storing because that is immediately hedged. This is a little bit different and there might be some part of the confusion with the gas supply. You remember that I mentioned that there is some negative effect on our gas business from the curtailments on the Russian volumes. So, of course, in principle, if you have a month ahead contract and a month ahead supply then you immediately hedge that to avoid the exposure to the market volatility.

However, if then volumes are being reduced then you have to make up for that loss in buying gas on the market to be able to supply your customers that you have contracts with. And in that sense, there has been a loss of around EUR 50 mn from these kind of hedges that we have made and that is why also Alfred has indicated that we are now dynamically reducing also the hedging on these contracts to reduce this exposure to this volatility in anticipation of further curtailments, which I think we have have met quite well. So this is the areas that we are seeing. You might then wonder why the gas business is even less than the minus EUR 50 mn, because we also had to apply IFRS 9, which is more or less collective liabilities or collective writedowns when it comes to credit risk of some of the counterparties that you can imagine, are also suffering there. So part of the loss of around EUR 115 mn in the gas business is also attributable to this.