

Q1-3 2022

MANAGEMENT REPORT Q3 2022

ECONOMIC ENVIRONMENT

The global economy came under unprecedented pressure in the first nine months of 2022. High inflation was a major challenge over and above the COVID-19 pandemic and the war in Ukraine. Geopolitical disagreements have exacerbated the energy crisis and pushed inflation expectations even higher.

In August and September, economic activity worldwide was low. The composite Purchasing Managers' Index (PMI), which reflects the situation in both industry and services, stayed below 50.0 points, compared with 50.8 points in July.

Conditions in the euro zone have also deteriorated yet further. Economic activity in the region has fallen to its lowest level in the past 20 months, mainly due to high inflation, the rapid rise in energy prices, growing economic uncertainty, and weakening demand. The number of new orders fell to a two-year low, and export volumes declined significantly.

At the same time, Europe is facing an increasingly critical situation in terms of natural gas supplies from Russia. Eastern European countries such as Hungary, Slovakia, and Bulgaria are most affected, causing GDP to drop by more than 4%. In Western Europe, Italy suffered the most from the gas market deficit (which could cause GDP to shrink by about 3.5% in 2022), whereas the economies of the Scandinavian countries were affected to a much lesser extent.

Business activity in China's industrial and service sectors showed positive momentum in September 2022, with the index exceeding 50 points, although it was slightly lower than a month earlier. Growth was driven mainly by large industrial enterprises, real estate development and telecommunications companies, as well as financial institutions.

While annual inflation in the USA remained quite high in September (despite decreasing slightly to 8.2% from 8.3% in August), in actual fact, this was the lowest level in seven months. According to the European Central Bank (ECB), inflation in the euro zone reached 9.9% in September, up from 9.1% in August.

In search of ways to counter inflationary pressures, central banks around the world started tightening their monetary policies. At the end of September 2022, for example, the Federal Reserve (Fed) in the USA raised the key interest rate by 75 basis points to 3.25% (for the third time in a row); in October, the ECB decided to raise the three key ECB interest rates by 75 basis points each.

Given high inflation, GDP forecasts are very cautious. The International Monetary Fund (IMF) expects global growth of 3.2% in 2022 and of 2.7% in 2023. Euro zone GDP is expected to rise by a mere 0.5% in the coming year. While growth in the world's three largest economies – the USA, the European Union, and China – is expected to stagnate in 2023, more than one third of the global economy might slip into recession, including Russia, Germany, and Italy.

According to the IMF, economic output in the USA will increase by only 1.6% and 1.0%, respectively, in 2022 and 2023. As for China, which still recorded GDP growth of 8.1% in 2021, the IMF now expects growth rates of 3.2% and 4.4%, respectively, for 2022 and 2023.

RUSSIA

Geopolitical factors, including the introduction of extensive restrictive measures against Russia, had a negative impact on the country's economy: GDP fell by 4.1% year on year in the second quarter of 2022 and by 0.4% year on year in the first half.

By the end of September 2022, consumer prices in Russia had jumped by 13.7% year on year (compared with 10.4% year on year at the end of August and 14.38% year on year for the first eight months of 2022). According to the Central Bank of the Russian Federation, inflation will be between 11% and 13% this year, fall to between 5% and 7% next year, and reach the target level of 4% in 2024.

The PMI for the manufacturing sector declined to 50.7 points in October 2022, down from 52.0 in the previous month. Although this was the sixth consecutive month that saw an increase in industrial activity, new orders rose at the slowest pace in four months owing to both the weakest growth since July and only slight improvements in production. At the same time, foreign orders fell sharply due to the restrictions placed on international trading partners as a result of the sanctions, while employment contracted for the seventh time in the past nine months.

By contrast, backlogs of work decreased at the fastest pace since June 2021, and post-production inventories increased for the first time since May 2019. Delivery times lengthened at the fastest pace since July 2022, but purchasing activity saw the largest growth since August 2017. On the cost side, producer price growth accelerated whereas production costs remained virtually unchanged.

While many banks and institutes have been revising their forecasts upward since the Northern spring of 2022 in the light of signs that the recession in Russia this year would actually be much weaker, part of the predictions regarding a decline in GDP were shifted to the coming year. Moreover, some of the recession expectations for 2023 were even tightened.

At the end of September, both the Organization for Economic Cooperation and Development (OECD) and the European Bank for Reconstruction and Development (EBRD) lowered their GDP forecasts for 2022 from the previous -10% to -5.5% (OECD) and -5.0% (EBRD). The World Bank even expects Russian GDP to shrink by only 4.5% in 2022, the Russian government expects a decline of only 2.9%. For 2023, however, the World Bank has tightened its June forecast by 1.6 percentage points. Accordingly, Russia expects GDP to decrease by 3.6% in the coming year.

According to the Russian Ministry of Economic Development, the recession in the country will be 2.9% by the end of the year (with the sharpest decline occurring in Q4 2022); according to OECD estimates, by contrast, it could be as high as 5.5% year on year. Based on the forecasts of the Russian Central Bank, Russia's economic output will not bottom out until the first half of 2023.

In September 2022, the Russian ruble averaged RUB 60.06 per USD and RUB 58.80 per EUR, down 21.4% and 35.1%, respectively, compared with the rates in January.

OIL INDUSTRY

In September 2022, oil and condensate production in Russia returned to the level recorded in July after falling slightly in August due to a decrease in condensate and gas production as well as maintenance and repair work in the Prirazlomnoye field.

According to the numbers for the first nine months of 2022, the production of liquid hydrocarbons stood at about 400 million tons or 10.7 million barrels per day (mb/d), up 3% compared with the same period of the previous year.

At about 4.9 mb/d, oil exports from Russia via tankers and pipelines in September remained largely the same as in August. At the same time, there were signs of an increase in exports by rail, mainly to China. Generally speaking, the country began to shift its focus to China, India, and Turkey once European buyers started to abandon sea routes for importing Russian raw materials at the end of February 2022 due to reputational risks.

The sixth and eighth packages of EU sanctions, which will take effect at the beginning of December, will determine the dynamics of production in the near future. According to the forecasts of the Russian Ministry of Energy, production will decrease by 2% year on year.

The Ministry of Finance estimates that oil production volumes will reach 515 million tons in 2022 (compared with 524 million tons in 2021) and 490 million tons in 2023, corresponding to 10.3 mb/d and 9.8 mb/d, respectively.

KAZAKHSTAN

Given the close economic ties between Kazakhstan and Russia, the Kazakh economy has also been weakened by the effects of the war in Ukraine. These include rising inflation, the lack of development of the country's foreign trade with Russia (traditionally, its most important trading partner), and problems in logistics (such as higher costs and lower availability of trucks).

At the same time, however, revenues from crude oil exports were higher and the country's international perception as a potential partner as well as its growing importance as a regional hub both improved. The influx of people from Russia also augmented the number of skilled workers.

According to the Kazakh Bureau of National Statistics of the Agency for Strategic Planning and Reforms, inflation has been rising for ten consecutive months; it was 17.7% year on year in September and climbed to 18.8% in October 2022. This was the highest since September 2008, given ever escalating price increases for food (23.1% in October compared with 22.2% in September) and other products (17.9% compared with 17.0%) and services (13.5% compared with 12.3%). The largest price increase (12.3% compared with September 2021) occurred in the service sector due to the sharp increase by 13.1% in prices for rental housing.

In July 2022, the National Bank of Kazakhstan decided to raise the key interest rate to 14.5%, because the actual inflation rate was significantly higher than forecast against the backdrop of increased inflation expectations. Following the bank's September meeting, however, the rate was left unchanged.

Nevertheless, according to the Kazakh Ministry of National Economy, GDP rose by 3.1% in the first eight months of 2022; the real sector expanded by 3.3% and the service sector by 2.3%. The provision of services in connection with the production of natural gas increased by 2.7% and investments in fixed assets by 5.7%.

In April, the IMF estimated that Kazakh GDP would grow by 2.3% for the full year. In October, the IMF raised its forecast for 2022 to between 2.5% and 2.8% for 2022 and to 4.4% for 2023.

In September, the Kazakh tenge averaged KZT 475.5 per USD and KZT 470.6 per EUR, representing an increase of 9.3% and 4.5%, respectively, compared with the January rates.

In August 2022, unemployment rose by a mere 0.1 percentage points year on year to 4.9%. As of September 1, 2022, a total of 71,400 individuals were receiving payments from the State Social Insurance Fund due to the loss of their jobs.

OIL INDUSTRY

From January to August 2022, Kazakhstan produced 53 million tons of oil, down 1.1% compared with the same period of the previous year. Gas condensate production decreased by 0.8% year on year to 8.8 million tons. At the same time, the volume of oil production in the Kashagan field stood at 8.7 million tons, which equates to 83% of the planned amount; the shortfall stems from the failure of the gas separation unit at the Bolashak plant in August 2022.

Kazakhstan's oil exports fell by 4% year on year to 46.8 million tons in the first nine months of 2022. According to the Ministry of Energy, there are plans to boost the annual production of oil from 87 million tons to 100 million tons by mid-2024, which will require an increase in transportation capacity. Several possible routes are being considered: eastward to China overland and southward to Iran via the Caspian Sea.

In the first nine months of 2022, natural gas production in Kazakhstan was 39.4 billion cubic meters, up 0.6% on the indicator for the same period of the previous year. In September, however, production indicators fell to the lowest level since 2013, mainly due to a decline in associated gas production against the backdrop of falling oil production. At the same time, gas exports dropped 33.3% year on year to 4.6 billion cubic meters.

The domestic consumption of gas in Kazakhstan is growing against the backdrop of the planned gasification of most of the country's regions, which is expected to cover 65% of the country's population of 13.5 million people by 2030. According to the Comprehensive Plan for the Development of the Country's Gas Industry for 2022–2026 that was adopted in July 2022, commercial gas production is expected to increase by 15 billion cubic meters by 2030. However, QazaqGaz expects a gas shortage from 2024 and, accordingly, a reduction in all exports to zero by 2025.

PERFORMANCE OF THE PEWETE GROUP

At the Extraordinary General Meeting on August 16, 2022, the shareholders of Petro Welt Technologies AG (PeWeTe) decided to sell the Company's Russia-based business units, i.e., the following subsidiaries: OOO KATKoneft, OOO KATOBNEFT, OOO KAToil-Drilling, OOO Wellprop, OOO KAT.oil Leasing, OOO Petro Welt Technologies, and OOO Trading House KAToil. The Group completed the transaction by the end of August 2022. The profits and losses generated by these subsidiaries are reported as discontinued operations.

PeWeTe has also decided to terminate its business activities in Oman under the existing joint venture. As a result, the subsidiary that the Group put in place to provide its services under this joint venture, PEWETE EVO SERVICES LLC, will be liquidated. PEWETE EVO SERVICES LLC thus is also reported as discontinued operations. The majority of the Group's assets in Oman have been transferred to its activities in Kazakhstan.

Group revenue for the reporting period is EUR 229.8 million. Owing to the sale of the Russian subsidiaries, the revenue of these companies as well as their operating and other expenses are consolidated for the first eight months of 2022. Group revenue for the first nine months of 2021 was EUR 168.5 million. The growth achieved here was mainly driven by the fracturing business, which improved significantly due to the lifting of COVID-19 restrictions and the resulting increase in crude oil production.

SEGMENT REPORTING

WELL SERVICES AND STIMULATION SEGMENT

Thanks to the increase in both oil production and quotas under the OPEC+ agreement, revenue in the Well Services and Stimulation segment increased by 60.0% in 2022 year on year. Total segment revenue in the first nine months of 2022 was EUR 110.1 million (Q1–3 2021: EUR 68.8 million).

Revenue related to Russian subsidiaries in the first eight months of 2022 comprised EUR 100.1 million (first eight months of 2021: EUR 55.4 million). This was mainly due to the increase in the number of jobs (+36.5%) and the revenue per job (+32.3%).

DRILLING, SIDETRACKING, AND IPM SEGMENT

Revenue in the Drilling, Sidetracking, and Integrated Project Management (IPM) segment also developed along a positive trajectory. Total segment revenue amounted to EUR 110.6 million in the first nine months of 2022 (Q1–3 2021: EUR 90.4 million).

For the first eight months of 2022, revenue stands at EUR 110.6 million, up 42.2% compared with EUR 77.8 million in the same period of the previous year. While average revenue per job increased slightly by 2.2%, this was strengthened by the increase in the number of jobs from 170 to 236 jobs (+38.9%).

EXCERPTS FROM THE CONDENSED CONSOLIDATED INCOME STATEMENT FOR THE NINE MONTHS ENDED AS OF SEPTEMBER 30, 2022

in EUR thousand	Q3 2022	Q3 2021	Q3 YTD 2022	Q3 YTD 2021
Revenue	4,089	2,459	9,506	4,575
Operating expenses	(5,756)	(1,366)	(9,434)	(3,290)
Gross (loss)/profit	(1,667)	1,093	72	1,285
Administrative expenses	(2,481)	(3,839)	(6,946)	(6,681)
Other operating income	102	139	128	165
Other operating expenses	(275)	(147)	(573)	(387)
Operating result (EBIT)	(4,321)	(2,754)	(7,319)	(5,618)
Operating loss from adjustments for discontinued operations and loss from disposal of subsidiaries	(379,935)	5,541	(370,254)	7,962

STATEMENT OF FINANCIAL POSITION

The Group posted a significant decrease in assets and liabilities as of the reporting date due to the sale of its Russia-based subsidiaries, which was completed in August 2022.

EXCERPTS FROM THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS OF SEPTEMBER 30, 2022

in EUR thousand	09/30/2022	12/31/2021
Non-current assets, including	119,719	130,623
Property, plant, and equipment	18,907	125,941
Current assets, including	67,204	273,024
Trade receivables	1,567	69,971
Total assets	186,923	403,647
Equity and liabilities		
Equity	54,496	206,002
Non-current liabilities, including	128,154	132,118
Non-current financial liabilities to affiliated parties	128,516	126,310
Current liabilities, including	4,273	65,527
Trade payables	1,547	35,581
Total equity and liabilities	186,923	403,647

LEGAL NOTICE

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