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Methanex Corp. (MEOH)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Methanex Corporation Q1 2018 Earnings Call. I would now like to turn the conference call over to Ms. Kim Campbell. Please go ahead, Ms. Campbell.

Kim Campbell

Manager, Investor Relations, Methanex Corp.

Thank you. Good morning, everyone. Welcome to our first quarter 2018 results conference call. Our 2018 first quarter's news release, management's discussion and analysis, and financial statements can be accessed from the Reports tab of the Investor Relations page on our website at www.methanex.com.

I would like to remind our listeners that our comments and answers to your questions today may contain forward-looking information. This information by its nature is subject to risks and uncertainties that may cause the stated outcome to differ materially from the actual outcome. Certain material factors or assumptions were applied in drawing the conclusions or making the forecasts or projections, which are included in the forward-looking information. Please refer to our first quarter 2018 MD&A and to our 2017 Annual Report for more information.

I would also like to caution our listeners that any projections provided today regarding Methanex's future financial performance are effective as of today's date. It is our policy not to comment on or update this guidance between quarters. For clarification, any references to revenue, EBITDA, cash flow or income made in today's remarks reflect our 63.1% economic interest in the Atlas facility and our 50% economic interest in the Egypt facility.

In addition, we report our adjusted EBITDA and adjusted net income to exclude the mark-to-market impact on share-based compensation and the impact of certain items associated with specific identified events. We report these non-GAAP measures in this way to make them a better measure of underlying operating performance, and we encourage analysts covering the company to report their estimates in this manner.

I would now like to turn the call over to Methanex's President and CEO, Mr. John Floren, for his comments and a question-and-answer session period.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Thanks, Kim. Good morning, everybody. Our strong first quarter 2018 financial results continue to illustrate the earnings and cash generation capability of our company. Average realized methanol prices were higher in Q1 2018 compared to [ph] Q1 2018 (02:22) at $402 per tonne, and production continued to be very strong. We achieved a record for adjusted EBITDA of $306 million. Adjusted net income was $171 million or $2.03 per share. Our results were slightly below analyst consensus as a result of a higher discount than analysts forecasted. Analysts forecasted 14.4% versus our 15.4% achieved in Q1 and our guidance of 15%.

In addition, a build of produced product inventory of 59,000 metric tonnes, primarily due to timing of vessel shipments at the end of Q1 contributed to the slight miss. Methanol prices rose in January and February, moderated somewhat in March, and it remains strong into the second quarter of 2018. Our April contract prices in North America and Asia-Pacific remain unchanged from our March prices at $496 per tonne and $460 per tonne respectively. We recently announced our May contract price for North America, which remains unchanged. Our second quarter 2018 posted price for Europe remains unchanged from the first quarter at €380 per tonne.

Overall, methanol demand was 4% higher in Q1 2018 compared to Q1 2017. Demand for traditional chemical applications was steady and supported by healthy demand for acetic acid. Energy-related demand was solid reflected a stricter environmental regulations in China, higher energy prices and a strong methanol-to-olefins, MTO, demand.

During the quarter, MTO facilities that were not experiencing technical issues operated at high rates. We expect three other MTO plants currently under construction to be completed over the coming months, with the combined capacity to consume over 3 million tonnes of methanol annually at full operating rates.

Methanol supply was impacted in the first quarter by maintenance activities and unplanned outages in North America and the Middle East. As well, the diversion of natural gas from methanol production to residential heating impacted supply in China early in the quarter. Production levels for those facilities have improved following the end of the winter heating season.

In February, we announced that we'll be adding four new ocean-going vessels powered by methanol fuel technology to our waterfront shipping fleet. These vessels can run on methanol, fuel oil, marine, diesel or gas oil, and are expected to be delivered in 2019. With these additions, 40% of our waterfront shipping fleet will be powered by methanol fuel technology.

In Trinidad, we produced 459,000 equity tonne in the first quarter of 2018. We continue to experience gas restrictions and expect to receive approximately 85% of our contracted gas supply for the foreseeable future. In New Zealand, production in the first quarter was impacted by gas supply constraints as a result of regularly scheduled gas field maintenance and a damaged natural gas pipeline impacting gas deliveries from offshore sources.

We expect that natural gas supply to our New Zealand site will continue to be restricted in Q2 while repairs are completed. We are also currently undertaking turnaround and maintenance activities at our Motunui site. As a result, we expect our New Zealand facility to produce approximately 300,000 tonnes of methanol during the second quarter of 2018.

Our Chile I plant produced 166,000 tonnes compared to the 109,000 tonnes produced in the fourth quarter using natural gas from Chile as well as natural gas from Argentina through a tolling arrangement. We expect production from Chile to be higher in 2018 than in 2017.

The restart of our Chile IV plant is progressing well, and we expect to complete this project by the end of Q3 2018 at a cost of $55 million. We continue to progress discussions with gas suppliers in Chile and Argentina and remain optimistic that we can secure additional gas supply to underpin a two-plant operation running at higher rates by the end of the decade.

If we are successful in securing sufficient gas to support a two-plant operation, we anticipate spending an additional $50 million to refurbish our Chile I plant. This modest capital investment has the potential to add approximately 800,000 tonnes to our current operating capacity.

In Egypt, we continue to receive 100% of our contracted gas supply, and we achieved excellent results producing 165,000 equity tonnes during the quarter. We expect to operate at close to full operating rates with some risk of gas curtailments in Egypt summer months.

Overall, we maintain our guidance of 85% annual operating rates in Egypt. As a result of an agreement we reached with the lenders to the Egypt debt facilities, our Egypt entity distributed $62.5 million to its shareholders, of which $31.3 million is attributable to Methanex. This is the first distribution to shareholders from our Egypt entity since 2014 and reflects a strong production and cash generating capability of the Egypt facility.

We ended the quarter with $371 million in cash on the balance sheet. Methanex share of the cash, including our proportional share of Egypt and Atlas cash, was $355 million. We commenced a new 10% share repurchase program on March 30. And as of March 31, we purchased 650,000 shares for $38 million. The pace to complete the repurchase program will depend on methanol prices and our ability to generate excess cash. In all, we returned $66 million to shareholders through our regular dividend and share repurchases during the quarter.

Our planned maintenance capital to the end of 2018 is estimated to be in the range of $90 million to $105 million. During the quarter, we made good progress on developing our potential Geismar 3 production facility, including securing land adjacent to our existing Geismar 1 and Geismar 2 production facilities. The acquisition of the land provides the necessary space for a potential Geismar 3 production facility. We also recently obtained approval from the Louisiana Board of Commerce and Industry under an Industrial Tax Exemption Program for the potential Geismar 3 project and look forward to the continued support of our local community partners and the State of Louisiana.

We believe that potential Geismar 3 project would be advantaged relative to other projects being contemplated or under construction in the US Gulf. The Geismar 3 project would benefit from the existing infrastructure and economies of scale, as the combined site would be capable of producing approximately 3.8 million tonnes per year. Our preference is to bring a partner into the project that can add strategic value.

The next step in developing the project is to complete the front-end engineering and design or FEED, which could commence as early as the second half of 2018. There are a number of factors to consider before a final investment decision is made, and we do not anticipate having enough information to make a decision until mid-2019 at the earliest. We do not anticipate significant capital to be spent on the potential Geismar 3 project before reaching a final investment decision.

We are also pursuing debottlenecking opportunities related to our current Geismar 1 and Geismar 2 plants that could add between another 10% to 15% to existing capacity with very modest capital investment compared to newbuild economics, which we estimate today to be approximately $1,100 a tonne of capacity. We do not have any major capital expenditure beyond standard maintenance capital, restarting our Chile IV plant and possibly refurbishing our Chile I plant over the coming 15 months to 18 months.

We expect average methanol prices to remain steady in the second quarter of 2018 compared to the first quarter of 2018 based on our posted contract prices in April and May. Based on our guidance for New Zealand production in the second quarter, we expect production levels to be lower than the first quarter, which should result in lower earnings in Q2 versus Q1.

I would now be happy to respond to any questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Daniel Jester with Citi. Please go ahead.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.
Q

Hi, John, good morning.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Good morning.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.
Q

So it's – I mean, it's been a few quarters now since China announced that they wanted to do an ethanol mandate. So now that the dust has settled a bit, I'm just wondering how you guys are taking a look at that. How do you think that can impact methanol blending into gasoline in China and how do you think that can affect the MTBE market?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Yes. So they did announce a standard in a number of provinces to use some existing corn that they have. When we look at the actual details, there's not enough capacity to turn that corn into ethanol in China today. It doesn't mean they can't build it. But we're still watching that file. But right now, we don't think there's any real short-term impact to either methanol or MTBE demand. They would have to, [ph] like I said (12:15), invest quite a bit to have capacity to turn the corn into ethanol.

Most of the work in China recently on methanol has been at the high level blends, the 85% to 100% methanol kind of engines. And even the ethanol mandate we see is at the low level blend. So there could be some impact on some of the low level blends, but most of the work in the growth has been in the high level blend. We don't see that being impacted even if it goes – ethanol goes forward to the rate that's been announced.

On MTBE, I think asking the MTBE suppliers to answer that question is probably a little easier than me. There is methanol use in MTBE. And in China, and we've seen this – the ethanol situation evolve in Europe in the past and some switch to ETBE, but a lot stayed at MTBE. So I probably don't have great insight on the MTBE issue and other suppliers of MTBE would be better to answer that question.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thanks. That's very helpful. And then on the four new ships that you've ordered, should we take this as a sign that you have greater confidence that you're going to be able to complete both phases of the Chile project or are these to replace some of your older ships? And are you doing anything differently on these ships compared to the first batch of ships that you ordered? Thank you.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Yes. So these are ships replacing some existing vessels that are coming to end a life. We do a lot of backhaul cargos around the world, and a lot of the big shipping companies that mainly in this CPP products don't – won't use vessels that are over 15 years old. So it's just part of our normal rotation of our ships.

I'll remind you, our production capacity has increased quite substantially, and we're planning to increase it more in Chile. So that is our plan. So we're getting out ahead of what we think will be successful. Don't want to say we're starting up Chile while refurbishing Chile I yet, but we're getting more and more confident that that will be the case. So it takes a while to build these vessels. And like I said, we'll take delivery in 2019, which should line up with some additional capacity for our company, but early days on that yet.

As far as the technology, it will be exactly the same technology that we have on the seven vessels. We've learned a lot especially around how to deliver fuel into the engines. Because these are dual fuel engines, there's two different fuel delivery systems and methanol needs a different type of fuel delivery system than, let's say, diesel. So we've learned – we had competing problems. We had learned a lot. We'll apply those learnings into the building of these ships.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.
Q

Great. Thank you very much.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Thanks, Daniel.

Operator: Thank you. Our next question is from Jacob Bout with CIBC. Please go ahead.

Q

Hi. Good morning, John. This is [ph] Rahul (15:08) on for Jacob.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Hi.

Q

So, John, I just had a question on Geismar 3 versus Medicine Hat 2. So with your recent updates on Geismar 3, does that mean that a potential Medicine Hat 2 is on the sidelines? So – and -

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Well, I think -

Q

Yes, so -

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Go ahead.

Q

And how are you prioritizing both options as we look at this longer term?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Both are very, very good projects. Both are privileged projects versus other newbuilds or potential newbuilds in North America. When we looked – worked on both projects in a parallel way, we came to land on a third plant in Geismar. It seemed to have a little bit more advantage than Medicine Hat. Having said that, we're still working on Medicine Hat and some issues we have to overcome. And – I've always said the main one is how do we get the product from Alberta to Asia. And that requires rail and terminaling. So those issues we're still working on. And they're a little bit more difficult today than, let's say, they were a couple of years ago.

And then there's a whole carbon tax issue, getting certainty around that carbon tax issue. But the team is still working on that. We still think Medicine Hat is a great place to be producing methanol. It's got advantage gas. Been watching the gas price in Western Canada. It's been below $1 on the spot. So that would make up for a lot of the extra freight we'd have in railing the stuff to the coast and then getting it to Asia.

So we've just prioritized the G3 project over Medicine Hat. It doesn't mean that Medicine Hat is dead by any means, but it just means we're putting our efforts into G3. And I want to have a strategic partner for G3. And if we're successful in achieving that, I would say Medicine Hat may go forward more quickly than our current thinking. But we'll see how things evolve.

Q

Okay. Very helpful. Maybe just moving on to New Zealand, so we're seeing some supply side gas issues there. Could you maybe just provide an update on the repair work that's been done on the gas pipeline there? And do you expect some of these issues to creep into, say, the third quarter or should they be done by the second quarter?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Well, there were two issues in the quarter with gas. There was a planned regular maintenance for one of the large platforms, which we were informed of some time ago. So that was incorporated into our planning. Unfortunately, at that similar time or as that was actually being completed or near completed, one of the other suppliers of gas from a different platform or field had a damage to a pipeline. We don't really know today how long it's going to be out and we provided guidance on what we think our production will be.

I think we're fortunate to be doing maintenance on our two plants at the same time that this issue happened. So the net impact will be less than if it had to happen without our planned maintenance. So I think we're pretty lucky that these two events are concurring at the same time. But I think we're in contact with the supplier on a frequent basis, and it's probably a Q2 issue, but we'll see how the repairs progress and then we can guide on our next call.

Q

Thanks, John. That's it from me.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Thank you.

Operator: Thank you. Our next question is from Joel Jackson with BMO Capital Markets. Please go ahead.

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Hi. Good morning, John.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Hey, Joel.

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Maybe just first on cost. Is there something in your cost profile that's different than 2017, maybe higher cost, whether it's pre-SG&A, maybe some change in some of your gas methanol price sharing arrangements? Maybe the way you pay for gas when methanol prices stick around these kind of levels? Maybe – is there anything going on in your cost base versus 2017 that's different?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

No, nothing really changed, Joel. I mean, we do pay more for some of our gas as methanol prices increase. Quarter-to-quarter there may be slight differences in freight and backhauls. And the backhaul revenue is a big part of our net freight number. So sometimes we achieve a little bit more or a little less. But on the cost structure, there's really nothing up significant to report that's different. It's mainly quarter-over-quarter noise. And so really nothing there, Joel, to say.

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Okay. And back on G3, so you talked about your [indiscernible] (19:34) partner. You also talked about $1,100 a tonne estimate for new tonnes at G3 if I understood correctly. So – I mean, it sounds like you would go ahead without a partner. What conditions would you need a $1,100 a tonne to be comfortable in going forward with this plant? I mean, maybe considering where you're trading at versus [ph] replacement cost (19:58) different facets or sort of you rate.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. So our preference is to have a strategic partner. We certainly don't need the money to complete a project on our own. But we think there's a few partners that we are talking with that bring other than money, some other strategic advantages to our company and to our shareholders. So if we're not able to conclude a significant strategic value, then we'll do this on our own if the numbers work.

The $1,100 I mentioned was what we see for projects under construction are being considered. This project is nowhere near that order of magnitude. Part of doing the feed is to confirm the capital cost of the project plus or minus 10% instead of the 30% that we're at today. But there's a lot of advantages to this project versus what's being built out there now.

We've got existing facilities where we can take off gas from, which would make it more capital light versus a greenfield site. We've already got the terminaling, we've already got the [ph] floor bridge (21:06). So there's a lot, and then we'd only have to add about 50 people to the site. And so – we're working hard to really get the capital cost way below $1,000 a tonne.

So – and that's what – it's a fairly big plant. So you'd expect when you build a big plant, you can achieve much better than the thousand we used to guide to. But what we're seeing based on public information is projects under construction are being considered or in that $1,100 a tonne even without an oxygen plant or even terminaling. So we would not undertake a project in Geismar anywhere close to that type of capital.

I don't want to throw a number out today because we need to do our work. And it'll take us about nine months to 12 months to do that work. And then we'll have a bit more comfort about the actual capital costs. And then really it'll be a decision around what methanol markets look like as well as our ability to execute and what is a very tight labor market in Louisiana.

And that's part of what we're going to be doing over the next nine months to 12 months is to try to de-risk the projects that we have a real solid execution strategy that we don't experience the cost overruns that we've seen in so many other projects. So, provided we still continue to see the market grow at 4% or 5% and we can get comfortable with the capital cost, then we'll make that decision. But you shouldn't think of us spending any significant capital on this product till 2019 late or 2020. So -

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Yes. John, the partner, is that like a gas supply partner or having Chinese MTO off-take partner? What sort of – how do you find a partner?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Well, somebody that brings strategic value to our shareholders and our company. So there's a number of different partners that would qualify there. A gasifier would be great. Somebody that may want to build their own methanol plant in the region, somebody that takes – off takes a lot of methanol that – so there's a lot of different parties that would be very strategic for us and we're talking to a number of different parties.

So we haven't concluded with any particular party. And we're optimistic we will and that we'll achieve a strategic partner that will bring much more value over and above just their equity or capital to the project. So if we can achieve that, then we'll do it on our own. If we can get comfortable with the capital costs and in the execution, and that the market needs the product.

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Thanks, John.

Operator: Thank you. [Operator Instructions] Please limit your inquiry to one question plus a follow-up question. Our next question is from John Roberts with UBS. Please go ahead.0

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. Just to follow up on that. Would you consider bringing a partner into Geismar 1 or Geismar 2 – and/or Geismar 2? I know you don't need the cash, but if your partner brings strategic value to Geismar 3, maybe they would bring strategic value to the existing operations.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Anything I would add to shareholder value that would create value for shareholders, we would consider. We're not having any discussions today around other assets to bring partners into. But it doesn't mean that we couldn't do that. But right now we're focused on the potential G-3 project.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. And then back on the China fuel blending, if China is slow to build their ethanol capacity, and again, it looks like they're kind of slow off the mark here, could actually low-level methanol blending benefit here in the near-term if they want to blend in alcohol and just don't have the ethanol?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. I think they're already blending some low-level blends, but their focus has been on high-level blends over the past few years, and that's where we see 100% and 85% blends. They still have good supplies of gasoline. So I think the ethanol story, as we understand it, is really to use up some corn stock that's been there and probably not be able to use for food.

So I think that's the driving – and yes, using an alcohol to burn with gasoline helps with cleaner air. But where you really get the big benefit is that higher level blends. So I think this is a specific issue related to some corn inventory in China. And I think it will take some time for them to execute on what they've announced. We don't know how long, but certainly to build capacity and to build the infrastructure is going to take some years.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. But you wouldn't expect low-level methanol blending then to kind of reaccelerate?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

I think if they've got this plant to go at low level ethanol, it's unlikely that you're going to see additional, but we're watching it. It's developing. And again, the focus has been on high-level blends over the last few years.

John Roberts
Analyst, UBS Securities LLC
Q

All right. Thank you.0

Operator: Thank you. Our next question is from Hassan Ahmed with Alembic Global. Please go ahead.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Good morning, John.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Hi, Hassan.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

John, obviously early days, and God knows what direction this whole sort of China sanctions thing takes, the tariff side of things. But let's assume for a second that it does happen. How are you thinking about the impact on methanol? And let me just expand on that a bit further. I mean, obviously, I'm not sort of talking about the direct side of things, more the indirect side where obviously polyethylene is included in the list of tariffs.

So I would imagine maybe potentially MTO becomes maybe attractive in the long run were to use, but MTO operating rates go up as less imports from the U.S. go into China. Then you have the propane side because obviously propane has been mentioned on the tariff side as well. So maybe MTP operating rates go up as the PDH units out there on sort of getting enough propane, imported propane, to produce the propylene. So I mean, am I thinking about this the right way? I would love to hear your thoughts about it.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Yes. Based on what's been announced, that's the analysis that we would do. But trade wars are never good for anybody. We got a globally traded chemical. We like open markets, we like free trade. I don't know where this is going to go. With the products have been announced, yes, it would be positive for methanol and methanol imports, but it could escalate, which – who knows where that could go. I think we're very fortunate to have six sites around the world that we could switch our supply chain overnight to compensate for any potential one-on-one tariff between China and the U.S. as an example. It might be a little bit more costly, but it wouldn't prevent us from selling into China.

I really don't know where this is going to go. And I hope cooler heads prevail, and I think global free trade has really helped all economies around the world. And I think there's lots of proof out there that, that's the best way to move people into the middle class. So I'm optimistic that there's a lot of talk, but not a lot of action yet, but we do have tremendous flexibility to respond to any potential China, U.S. escalation.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Fair enough. And just sticking to China, as a follow-up, I know a couple of months ago on the earnings call, you were talking about the Chinese inventory levels, the methanol inventory levels being quite low. Is that still the case on the Chinese side, any commentary about sort of global methanol inventory levels as well?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Yes, it's still very low in China, remarkably low. I don't know if you've been following the spot market in the last few days, but it's been now well over $410 a tonne again. So – and then the inventories as reported are pretty low, and that's despite a number of empty oil plants under maintenance. So everybody was thinking the sky was going to fall when the MTO plants go under maintenance and here we are going the other way.

So I think being a forecaster is a tough thing to do, whether it's weather or methanol prices. And I think we look at supply/demand balances and we're quite optimistic in what we see is leading to a very solid price market for methanol.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Superb. Thanks so much, John.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Thanks, Hassan.

Operator: Thank you. Our next question is from Nelson Ng with RBC Capital Markets. Please go ahead.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.
Q

Great, thanks. So, John, you mentioned the pipeline that got damaged that brings gas from offshore sources. Roughly what is the mix between, I guess, offshore and onshore gas supplies for your New Zealand facilities?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Majority is offshore.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.
Q

Okay. And then I guess following on that, any kind of initial thoughts on I guess New Zealand's decision to no longer give out, I guess, offshore oil and gas exploration permits. I know it's more of a long-term thing. But what are your initial thoughts on that?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.
A

Well, I think they've announced the ban on new permits, not existing permits. There hasn't been a lot of new permits issued in New Zealand because of the low oil price. Obviously, on a long-term basis, it's not positive. There are a lot of existing blocks that have a lot of reserves that continue to be developed and drilled. But I think it kind of caught us off guard and the industry off guard, new government there.

So first time they've been in the seat of government for quite some time. So, not positive for us on a long-term basis, probably zero impact on a short-term basis. But we're certainly working with the government. They were down to our sites. The Energy Minister and the Prime Minister is coming down to see us as well in May. And we're just trying to understand the rationale for their decision making and see – and the industry itself the upstream trying to understand where the government is heading on this issue. And as it evolves, we'll be able to report more. But I think you're right to characterize it more as a longer term issue but not positive.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.

Q

Okay. And then just a quick one on Geismar 3. So the 1.8 million I guess metric tonne capacity, like how did you arrive at that? Is that based on the size of the land available pipeline capacity? Or could the size of G3 change plus or minus 10% or 20%.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. It's pretty standard technology that we're pretty familiar with and it would be oxygen-based. So I think when we look at how much do we want to have on that site today, that was a nice number. That had nothing to do with pipeline capacity. We got had lots of land there. We've got enough land to build another three plants if we want, two or three if we want, but we may also look to attract customers there.

It's a nice site. Having a methanol producer there, I know there's a number of customers looking to add capacity in the U.S. because the conditions in the U.S. are very favorable today from a cost perspective and tax perspective. So it gives us tremendous flexibility even if we wanted to have an oxygen plant on the site and not buy across the fence.

So having land in that area that you can use in the future I think is a really good option value. And right now, I wouldn't want to speculate on anything else, but a potential G3 project where we certainly have tremendous flexibility now with the acquisition of the land right next to our site.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.

Q

Okay. Thanks, John.

Operator: Thank you. Our next question is from Laurence Alexander with Jefferies. Please go ahead.

Laurence Alexander
Analyst, Jefferies LLC

Q

Good afternoon. So two quick ones. Can you update on how you are seeing the regulatory incentive framework for industrial boiler use in China? And then after the – can you give a sense for the MTO? How much demand comes back on after this maintenance turnaround period winds down and what the pipeline looks like after the next three plants?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Okay. On the – so the coal boilers application today is about 1.8 million tonnes and growing. So that continues to evolve. We're working with the government and the boiler manufacturers on standardization, specifications, safety and handling.

We would expect that application to continue to gain quite a bit of momentum as they look to replace coal boilers with more clean burning fuels like methanol and natural gas. Exactly how it's going to grow is a bit of a guess. But it's kind of grown pretty quickly, and we're really wanting to work on the standards and safe-handling of methanol into that application. There's 500,000 of these in the country, and each in a year would use a thousand tonne. So we're really at a very, very small penetration in what could be a very large application.

As far as MTO, there's about four plants down for maintenance at for different lengths of time. So about 500,000 tonnes in the quarter kind of off, if it at all comes back and runs at full rates is that order of magnitude. So it's not insignificant in the quarter. I think there's also a lot of unplanned and planned maintenance around the world. So how does that come back, how do those plants run? These are the things we watch each and every day as we make our pricing decisions and our outlook.

As far as there's the three plants I mentioned, there's not a – there's a lot of announcements I'd say on the next potential wave of MTO, but not a lot of steel on the ground. So certainly as oil prices have gone up and NAFTA prices have gone up, it's positive for MTO. But I think right now there's a bit of a wait-and-see how the markets evolve. Hassan mentioned the potential PDH issues in MTP. So I think in our forecast, we have a few more as we get to the end of the decade, but really what's being built or has been built and under construction is probably what we're going to see for the next few years

Laurence Alexander
Analyst, Jefferies LLC

Q

Okay. Perfect. Thank you.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Thanks.

Operator: Thank you. Our next question is from Steve Hansen with Raymond James. Please go ahead.

Steve Hansen
Analyst, Raymond James Ltd.

Q

Yes. Good morning, guys. John, in the past you've mentioned the idea of a substantial issuer bid at some point this year once a sufficient cash pile builds up. Maybe just a quick update on your thoughts there, the timing, if you have any sort of sense around that or how much cash you would need to go ahead with such a plan. And just as a related point, is there any decision – or is there any influence on the substantial issuer bid based upon your G3 announcement or the idea of G3 perhaps accelerating it a little sooner than some might have thought?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

No. So, no impact at all. We're going to generate a ton of cash at current prices, and we'll be able to complete an NCIB. We may be able to do a substantial issuer bid depending on how pricing evolves in the second half. There's a lot of people pretty negative on pricing for the second half. So we'll see how it evolves.

I think we'd like to do it around $300 million on a substantial issuer bid. So – and G3, like I said, we're not going to have any major capital spend till late next year. So really our capital allocation has not changed at all. I mean, we have not made the FID on G3. We have a lot of work to do to tie off some of the risks as well as make sure that the market needs the product and that we can deliver it into Asia where all the product will go at a cash cost that is on the cost – on the point of cost curve that we think during the next potential downturn that we'd still be very cash positive.

So there's a lot of work we've got to do, but our capital allocation has not changed at all. We're just getting a little bit more directive on G3 because we got the land, and we're – we've been progressing this project for some years. So there's another milestone. But there's still a lot of work to do. But we're optimistic we can have something in the 2022 period that could be very interesting from a cost point of view and the market will be looking for the product at that time and versus other projects being considered. And other products [ph] enter into (39:00) construction, this will be much more competitive. And right now, if you look around the world, the only places that are really announcing any significant capacity is the United States – for obvious reasons. So we'll continue to work on it, but it really hasn't changed our capital allocation strategy.

Steve Hansen
Analyst, Raymond James Ltd.

Q

Okay. No, it's helpful. It does sound compelling. Maybe this is a follow-up I think on a question earlier, but this may go back several years now. So maybe the thoughts are outdated. But I do recall you mentioning in the past the idea of these 1.6 million, 1.7 million tonne plant is being less desirable just in the context of some of the technology not being quite as reliable and/or the idea of downtime being a little bit more significant once they go down. Is that sort of an issue these days in your mind it seems?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Well, our team has been doing a lot of work on that very issue. And we have two models now. Conventional steam reforming, which we can get up to 1.2 million tonnes and then 1.3 million tonnes and then oxygen-based. And the challenge with the oxygen-based is we didn't have much experience in running oxygen plants, and when we had them third-party, they didn't have redundancy built into their oxygen plants. So when it went down, we went down.

I think Louisiana is a much different situation because you have a number of suppliers, you have ability to buy pipeline oxygen. And like I mentioned that we have enough land if we want to consider our own oxygen plant. So I think it's quite different. I think we've also got more comfortable and better at operating oxygen plants that are different. And even the steam reforming plants in the early years took us many, many years to figure how to run those.

So I think we have two models, and depending on where in the world and what the conditions are at that particular location, we'll use either or. So that's where we've landed on our new build philosophy for production capacity.

Steve Hansen
Analyst, Raymond James Ltd.

Q

That's helpful. Thanks. That's it from me. Thanks.

Operator: Thank you. Our next question is from Charles Neivert with Cowen. Please go ahead.

Charles Neivert
Analyst, Cowen and Company, LLC

Q

Morning, guys. Just under the wire on morning. Looking at the plants in Chile, you said – I think this quarter you got, was it 40,000 tonnes that your production came through gas supplied by Argentina. Is that going to be consistent going forward from here or is it sort of every quarter you have to figure out what you're going to get or they're going to figure out what you get? And what are we looking for? And if you have some ideas, what it looks like for the next few quarters going forward?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. What we've always said about the operation down there is – during their winter period, we'll operate at lower rates. During their summer period, we'll operate at higher rates. That's from both Argentina and Chile. The town of Punta Arenas consumes more gas in Chile. So in Argentina, they consume more gas in the wintertime than in the summertime.

I would say we're going to continue to receive gas on the tolling going forward. It may be more restricted in their wintertime, like I mentioned. But we're in talks with a number of different suppliers on the Argentinean side to get additional gas on a contracted basis during their next summer. So haven't been successful in concluding anything. But I would say you should expect higher operating rates in their summer than in their winter.

Charles Neivert
Analyst, Cowen and Company, LLC

Q

Okay. And this would be a bit of a high class problem. But if – looking forward, if Chile is able to produce enough gas that both your plants could conceivably run in Argentina through other things that now has more gas. Is there – I won't say a preference, but is there a hierarchy there as who's going to supply the gas? Obviously, Chile would prefer to supply it if they've got it. But is there some sort of rule that's going to work if they, for lack of a better word, clash at some point?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Well, I think competition is always good. Competition is good for our pricing, and we're the only big consumer of gas in that part of the world. So having a competitive situation is always better than having a sole supplier. Certainly as we're discussing these various issues with the suppliers, that's a big point of discussion. So nothing to report today. But to me, I always like to have multiple suppliers as opposed to one. But we'll see how things evolve.

I think we've been very pleased with the progress on the Chile side, and they're continuing to be successful on their exploration development of gas. We're big consumers. So we're a big part of the solution down there for Enap. And we're working closely with them on this. I think our solution though to get the two plants running at full rates is partially Argentina. So how much of each, when, how much in the summer and the winter, those are all things that we're working through.

Charles Neivert
Analyst, Cowen and Company, LLC

Q

Okay. Thanks very much.

Operator: Thank you. Our next question is from Matthew Blair with Tudor Pickering Holt. Please go ahead.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Hey, good morning, John. How are you doing?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Good morning. Good.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

I was hoping to come back to G3. Could you talk about how you would finance such a project? Just kind of rough number, it looks like it would be roughly around $1.5 billion or so. What kind of split between debt and equity should we expect? And would this be something where you would plan to build a lot of cash on the balance sheet before you really ramp up the CapEx here?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes, it's too early to even go there. I mean, if we have a partner, we're not going – we're not going to need very much. I mean, there's a lot of brownfield advantages to that plant that we would like to monetize. So we – when we look at we get a partner for that project, we're not going to have very much of our own capital. But we're going to go through the work in the next nine months to 12 months to firm up the capital cost. I think the number you're throwing out is way premature to be even talking about numbers. So we haven't done our work yet. But if we bring a partner in, our actual cash contribution to this new project will be very minimal.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Got it. And then production was really quite strong in the quarter. Three of your six sites ran above nameplate capacity. How were you able to do this? Is this a result of de-bottlenecking that's already occurred? And what should we expect going forward here? Thanks.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Remind you when we talk about nameplate, that's over the average cycle of the catalyst. Right? The catalyst is changed out every three years to four years. So when you put in new catalyst, you get a higher operating rate, and as you get to the end of the catalyst life, you get a little lower operating rate. So that nameplate of the average of that cycle. So, yes, there are times when we'll run a little bit stronger. Some of the plants can run a little bit above nameplate but I think we're comfortable guiding to nameplate.

And we again had a really, really strong reliability in the quarter. Our target has been 97% for a long time, and we achieved almost 99%. So that had a huge impact on what you just were mentioning. So all sites ran well. It was a record production I think by a ton. I don't know how he got a ton more, but anyways, we got a ton more.

And our plants are performing extremely well. We've invested a lot in the plants, we've invested a lot in the people, we've invested a lot in understanding the reliability issues we've had. And we're benefiting from some of those investments doesn't mean we're not going to have issues going forward. But the investments we made certainly paid off in Q1. And the goal and the challenge for the team is to maintain that kind of production level, and we'll see how things go for the balance of the year.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Very helpful. Thank you.

Operator: Thank you. Our next question is from Jonas Oxgaard with Bernstein. Please go ahead.

Jonas I. Oxgaard
Analyst, Sanford C. Bernstein & Co. LLC

Q

Good morning, guys.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Good morning.

Jonas I. Oxgaard
Analyst, Sanford C. Bernstein & Co. LLC

Q

I was wondering a little bit, you said you're looking at debottlenecking. This is the typical response that high margins. Have you seen the industry at large looking at debottlenecking right now, or have they already done so in the previous price hike?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Well, I think we have unique opportunities that others wouldn't have. When I'm talking about debottlenecking, it's similar to what we did in Medicine Hat a number of years ago. When we refurbished the plant, we were able to secure a stream of CO_2 from a neighboring plant. And by adding in the CO_2 that for very modest capital, we're able to get into our 10% to 15% capacity out of the existing steel. So that's what we're looking at in Geismar. The plant in Geismar is a steam reforming plant. The two of them similar to Medicine Hat. There is excess CO_2 and other off gases in the region that are being used for fuel or other applications that may have more value to make methanol.

So we were talking to potential suppliers, and I think that's another great thing about the Geismar side, as you have all these interconnections and all these potential suppliers of these other off gases that you can buy at very low and for a very low capital, add capacity. So I think we are unique in that area. So we'll continue to pursue it. And that's another way to add capacity couple of hundred – 300,000 tonnes without much capital.

Jonas I. Oxgaard
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Thank you. And on the flipside of that -

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

It makes sense under any methanol price environment. So it's not just the high price that we would do this.

Jonas I. Oxgaard
Analyst, Sanford C. Bernstein & Co. LLC

Q

That's fair. And so you haven't heard from other participants in the market, them doing similar things?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

We have not.

Jonas I. Oxgaard
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. The flipside of that question, the MTO producers in China have been running at persistently negative margins for quite some time. We're hearing rumors that they're looking at getting ethylene into pipeline instead of running their own plants but haven't seen anything specific. Have you heard anything around those plants?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Well. The MTO producers have not been running at negative margins. They've been running at positive margins. When you look at the side on an integrated basis, we have not heard rumors about ethylene pipelines into the MTO plants, but you probably have a better pipeline than we do on rumors. So we'll continue to see what actually happens and what's actually the results and the behaviors. Then we'll report accordingly.

Jonas I. Oxgaard
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Thank you.

Operator: Thank you. Our last question is from Chris Shaw with Monness, Crespi. Please go ahead.

Chris L. Shaw
Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Good morning, everyone. How are you doing?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Hi, Chris.

Chris L. Shaw
Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

I think as long as I've covered you guys, it's been four, five years now. You guys have always traded at a discount to I guess replacement cost. I think that's probably about $700 to $800 a tonne right now. I mean, if this is a – if you guys hold a view that you'll continue to trade at a discount to replacement cost for, I don't know, a decade or so, how does that – I mean, if you have the view or – do you have that view? And if so, how does that like impact your I guess decisions around the new capacity particularly I guess G-3?

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Replacement cost is one measure of evaluation of a company. I don't know of any chemical company that trades at replacement cost on a sustainable basis. Certainly if you're trading at half your replacement cost, you're discounted. But if you're close to 80%, I think that's where most chemical companies trade over the cycle.

Also the trade at full replacement cost, I think you'd have to have 25-year gas contracts to underpin each and every one of your assets, which we don't have. And each and every asset would have to be refurbished to new condition. And that's certainly not our case as well. So I think we use replacement cost as a proxy as one valuation. But I think we're always going to trade at how much EBITDA we can generate and a multiple of EBITDA, and therefore cash and what we do with that cash.

We've been very disciplined in our approach to capital allocation. We've returned a lot of money to shareholders in dividends and share repurchases. We used to have 200 million shares. We're now just north of 80 million. We've had a sustainable growing dividend since 2002, returned a lot of cash that way. And our return on capital employed, I would stack up to any chemical company in the world. We've been very disciplined when we've made an investment. Our hurdle rate is 13% on capital employed. And in markets like this, we're exceeding that significantly.

So if you look at the average of the last 12 years, 13 years, we've had a really, really solid return on capital employed. So we'll remain disciplined. And I think we think, as we've done in the past, we can do all three. We can buy back shares, we can have a meaningful sustainable growing dividend, and we can grow the company as long as the market is there that needs more methanol. We have about a 15% market share. We'd like to grow our market share in line with the growth of the industry.

We're not looking to make it 20%. But as the industry grows and the market grows, we'd like to maintain around that 15%. And if we can't do that with projects that have a really high probability of returning more than 13%, then we'll return capital to shareholders in the form of buybacks and dividends. That hasn't changed. And that's what we're going to do.

Chris L. Shaw
Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Great job. Thanks. That's what I was looking for.

John Floren
President, Chief Executive Officer & Director, Methanex Corp.

A

Thank you.

Operator: Thank you. There are no further questions registered at this time. I would like to turn the meeting back over to you, Mr. Floren.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Thank you. We are very pleased with our first quarter 2018 results. In the first quarter, we achieved record adjusted EBITDA and adjusted earnings per share. Our strong performance reflects the investments we made in our production assets over the last few years and enable us to generate significant cash flows across a broad range of methanol prices.

Also the leverage to our strong earnings has improved dramatically as a result of our recent share buyback program. Since 2013, we have reduced the share count by 14%. Our priorities for capital allocation are to continue to meet our financial commitments, pursue our growth opportunities, and return excess cash to shareholders through dividends and share buybacks.

Our Annual General Meeting will follow later this morning at 10:30 AM Pacific Time. This meeting will be focused on the business items outlined in our information circular. The meeting will be webcast live on the Investor Relations section of our website at www.methanex.com. Thank you for the interest in our company.

Operator: Thank you. The conference has now ended. Please disconnect your lines at this time, and we thank you for your participation.