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Methanex Corp. (MEOH)

Q3 2018 Earnings Call

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Jacob Bout
Analyst, CIBC World Markets, Inc.

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Analyst, BMO Capital Markets (Canada)

Daniel Jester
Analyst, Citigroup Global Markets, Inc.

Steve Hansen
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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Methanex Corporation Q3 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.

Good morning, everyone. Welcome to our third quarter 2018 results conference call. Our 2018 third quarter 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 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 third 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 on 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 the question-and-answer period.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Thanks, Kim. Good morning, everybody. We've had an outstanding first three quarters of the year and we're extremely pleased with our financial performance as we recorded adjusted EBITDA of $874 million in the first nine months of 2018. This is the highest adjusted EBITDA recorded in the company's history and surpasses the record adjusted EBITDA of $838 million that we recorded in the full year of 2017. These results demonstrate the significantly improved earning powers of our business.

Our third quarter 2018 results were very strong. Ethanol prices have remained robust in the third quarter and our average realized price increased to $413 per tonne compared to our average realized price of $405 per tonne in the second quarter. We recorded adjusted EBITDA of $293 million and an adjusted net income of $152 million or $1.92 per share. Our sales volume of 2.9 million tonnes was also strong and matched prior records. We believe that methanol prices have remained robust this year due to strong industry fundamentals.

Methanol demand in the third quarter of 2018 was strong. Methanol-to-olefin or MTO operating rates rebounded in the third quarter as several facilities resumed production following planned maintenance activities in the second quarter and the first half of the third quarter. We continue to observe high operating rates for most MTO facilities. We continue to monitor the progress of new MTO units that are currently under construction and targeted to come online in the near-to-medium term.

Methanol industry supply increased marginally in the third quarter as new supply from the nat gasoline plant in the United States was offset by various production outages globally, which sustained tight market conditions. As we enter the fourth quarter, the Marjan plant in Iran had started producing methanol although rate of production remains uncertain. We continue to monitor the enforcement of China's environmental regulations and the potential curtailment of methanol production in China as the winter season approaches. New supply from the U.S. and Iran and the startup of our owned Chile IV plant will help to fulfill growing methanol demand.

Now turning to our operations. Our third quarter production results were impacted by some gas restraints in New Zealand and some mechanical issues at our Trinidad and Egyptian plants. In New Zealand, we produced 478,000 tonnes during the third quarter compared to 252,000 tonnes in Q2. Production was higher in the third quarter compared to the second quarter as the major turnaround activities were completed at the end of June. However, production was impacted in the third quarter as we experienced gas restraints resulting from natural gas suppliers completing planned and unplanned maintenance activities. We expect the gas constraints to be resolved in the fourth quarter.

In Trinidad, we produced 353,000 equity tonnes in the third quarter of 2018 compared to 442,000 equity tonnes in Q2. Our production results were lower compared to the second quarter, primarily due to mechanical issues, power outages and an earthquake. These mechanical issues have now been resolved. We continue to experience gas restrictions and expect to receive approximately 85% of our contracted gas supply for the foreseeable future. In Egypt, we produced 128,000 equity tonnes in the third quarter of 2018 compared to 165,000 equity tonnes in Q2. Our production results were lower compared to the second quarter, primarily due to mechanical issues related to the supply of off spec natural gas when the natural gas from the Zohr field was introduced to the grid. We continue to receive 100% of our contracted gas supply and reiterate our updated guidance that we expect to operate at close to full operating rates annually for the foreseeable future.

In Chile, we produced 112,000 tonnes during the third quarter compared to 128,000 tonnes in Q2 reflecting lower gas deliveries during the southern hemisphere winter months. We are very pleased to announce earlier this month that we restarted and produced methanol from our Chile IV plant for the first time since 2007 and began to receive contracted natural gas from Argentina for the first time in 11-years. We expect the plant to ramp up to full production rates over the coming weeks. Our team did an outstanding job of completing this project safely on time and on budget. We expect that our current gas agreements will allow for a coupon operation in Chile during the southern hemisphere summer months and approximately 75% of a two-plant operation annually until mid-2020. Our production rate in Medicine Hat was impacted in the third quarter, as a result of an interruption in the supply of CO2 from our supplier, which was restored late in Q3.

Now turning to our financial results, we ended the quarter with $261 million in cash on the balance sheet. During the quarter, our Egypt entity distributed $80 million to its shareholders, of which $40 million is attributable to Methanex. Methanex share of cash including a proportional share of Atlas and Egypt cash was $249 million. Our balanced approach to capital allocation remains unchanged. We believe we're well positioned to meet our financial commitments, pursue our value adding growth opportunities and return excess cash to shareholders through dividends and share repurchases. Our planned maintenance capital from October 1 2018 to the end of 2019 is estimated to be approximately $175 million.

We continue to progress multiple advantaged opportunities to grow our production capacity and further improve our earnings power and cash generation capabilities over the coming years. We anticipate spending an additional $50 million to refurbish our Chile I plant over the coming years to ensure the long-term reliability of the plant. The timing of this investment will depend on our progress to secure sufficient gas without seasonal restrictions to underpin the continuous two-plant operation. Our team is continuing to make progress on a potential project that would allow us to debottleneck our existing Geismar assets by approximately 10% for a few tens of millions of dollars of capital. The plan will be to carry out these debottlenecking projects during planned turnarounds over the next few years.

Finally, we've begun the frontend engineering and design or FEED phase for the potential Geismar 3 production facility. We expect this process will continue over the next nine months and will enable us to consider a final investment decision by mid-2019. We expect to spend approximately $50 million to $60 million on this project prior to reaching a final investment decision. Our preference remains to have a partner that can add significant strategic value to the project.

In the quarter, we repurchased 1.6 million shares for $113 million during the quarter under our share repurchase program. Up to October 24th, we've repurchased 5.8 million shares or 88% of the 6.6 million shares approved under the current Normal Course Issuer Bid. In total, we returned $139 million to shareholders through our regular quarterly dividend and share repurchase program in the third quarter.

Our outlook for the fourth quarter is positive. Methanol prices continue to be strong and we expect our production levels to be higher in the fourth quarter of 2018 compared to the third quarter. As a result, we expect adjusted EBITDA to be slightly higher in fourth quarter compared to the third quarter of 2018.

I would now be happy to respond to any questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question is from Mike Leithead of Barclays. Please go ahead.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Good morning, John.

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

A

Good morning.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

I guess if I could start by looking at your cash flow, you guys have been generating annual EBITDA north of $1 billion, your dividends is about $100 million annually and you're guiding CapEx to about $230 million through the end of 2019. So it seems like you should have a fair amount of excess cash available, particularly if you have about 1 million shares left on your buyback through March. So can you help frame how we should think about the deployment of that cash and if we should expect a special dividend or some other method of distribution?

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

A

Yeah. Really no change to our philosophy. So three pillars of that is to grow the company, and we have some very interesting low cost projects to do so and we'll be pursuing those between the debottlenecks and the FEED on Chile – sorry, Geismar 3 and the Chile refurbishment over the next couple of years, you're talking $150 million give or take maybe a little less than that. Our second pillar is dividend. So we have a dividend policy that's sustainable growing and meaningful. So yield target of 1.5% to 2.5% kind of range. We'd like to grow at each and every year which we've done except for the financial crisis. And as we buy back shares, we can grow the dividend without really a lot of additional cash outlay because you know that we will have to be able to grow it without spending any more cash.

Our third pillar is share repurchase. We prefer the NCIB, Normal Course Issuer Bid, up to 10% of the shares per year. It gives us tremendous flexibility. We are in a commodity business. We see volatility as we've seen here in the stock markets here in the last few days. So it gives us tremendous flexibility to increase or decrease depending on what's happening in the market. So that's our preferred way to return money to shareholders through repurchases on the NCIB.

Having said that, you're right to point out at current prices, we generate a heck of a lot of cash. And what we've always said and nothing's changed is that, if – we need about $200 million to $250 million at these kind of prices to run the business, as prices are higher, we need a bit more working capital. If we're fortunate enough to have an excess $300 million above that and we can't do an NCIB, then we've always said we consider a substantial issuer bid. So nothing's really changed, those are the three pillars of what we do and that's how you should expect us to move forward.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. And then on G3, you've undergone much of the initial work so far on your own. Is it fair to presume the hurdle would be higher for a partner to sign on today relative to maybe six months ago? And is there any sort of kind of drop-dead date in your mind in terms of going solo versus in a partnership?

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

A

Well, we've always said, we're looking for a strategic partner. We're not looking for cash. And we've said that there's a significant amount of brownfield advantages to that project that of course we would want to be compensated for by any partner. So that's part of the negotiations as what we call a buy-in fee, which is not insignificant, if you look at all of the advantages that project has with the existing plants and the brownfields investments we've already made. You're right to point out as the months go by, the project becomes de-risk, so that fee is a bit more firm as I would say, but we don't have a drop-dead date. We'd like to have a heads of agreement signed by the end of the year. But as long as we're making progress and we see a way to attract and have a strategic partner that's our preference. But like I've said before, if we're not successful, we think the project is very attractive and we'll have to do it ourselves.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: Thank you. The following question is from Jacob Bout for CIBC. Please go ahead.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Hey, John.

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

A

Hey, Jacob.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

So a number of production issues in the quarter. Maybe talk about what if any of these production issues extend into the fourth quarter?

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

A

Yeah. I'd say though we said, we guided two or three turnarounds per year. We've done one this year, so you should expect us to be doing a turnaround in the fourth quarter, not going to say where or how long, but you should expect that. We've had these ongoing issues on the gas supply in New Zealand because of some technical concerns with the pipeline. We expect those to be resolved in the fourth quarter, but we would expect our operations to be impacted by the gas availability because of these issues in the fourth quarter. The other parts of the world, I don't anticipate any mechanical issues or further restrictions on gas other than what I've guided to in Trinidad.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Okay. And then maybe in Argentina, can you talk about the gas supply there and what some of the terms are? Is it fixed or is there a price participation? And then are there any outstanding litigious issues stemming from what happened 10 years ago? I mean imagine some of the suppliers would be the same groups that you've been dealing with 10 years, 15 years ago?

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

A

Yeah. The gas from Argentina is interruptible on our choice or their choice. But there is a big want to be selling the excess gas in their summertime to us. We pay in U.S. dollars and certainly the country wants U.S. dollars. The contracts are all a little different. They do have sharing mechanisms in them, but as far as legal, I mean, we've managed to resolve most of those issues and really you shouldn't be thinking any outstanding legal issues that are going to impact our ability to buy gas from Argentina over the coming months.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Thank you.

Operator: Thank you. The following question is from Joel Jackson of 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

John, you bought a lot of capacity on, you've had some better operating rates to different plants, better gas availability, but you're actually doing a lot of purchase methanol still and it was a bit of a drag in this quarter. Can you talk about a little about maybe why you're doing so much purchase methanol? Last quarter did you think that you may have had some other production challenges and so you're doing a little bit more for insurance or maybe just give a little bit of that dynamic? Thanks.

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

A

Yeah. Just to point out that our sales continue to increase as we've increased our production our sales increase, we're up towards the 11 million tonne number now. And as you do that you need to increase your inventories. We have a very slight inventory compared to our sales, traditionally 10 million tonnes, we've been keeping just around

1 million tonnes. So, we think we need to keep a little bit more inventory in our system to make sure that we can service our customers on time and reliably like we always have.

So a bit of the build would be related to inventory that we need to run the business as well, like, we were not planning on some of these issues in the quarter. We had some indication in New Zealand about gas, but we certainly weren't expecting earthquake in Trinidad and off spec gas in Egypt. So that did impact our production. So even though the levels were quite good, we were certainly forecasting for higher production levels than we obtained. So it's a combination of those two things that made us have a little bit slightly higher purchase product in the quarter, but our guidance is still the same.

We want to sell about 80% of our own equity molecules and the other 20% will be part of the off takes that we have with our partners in Egypt and Trinidad as well as some other off takes that we have on a medium to longer term basis and then some spot materials. So nothing's really changed. But you should expect quarter-over-quarter that sometimes it'll exceed and or sometimes it'll be a little lower than that. But right now, we're trying to get our inventories up to a state where we have a little bit more security supply for our customers.

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thank you for that. And then maybe just following up on a prior question, do you think like what you know now that Q4 in New Zealand should have higher production in Q3, about the same, little lower, what would you guess?

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

A

Well, I don't like to guess and since I'm not in control of the gas supply situation, I'm not in control of the repairs that they need to make. We're pretty well at the mercy of what they are going to do in the quarter. So I don't like to guess on those things.

Joel Jackson
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thanks.

Operator: Thank you. The following question is from Daniel Jester of Citi. Please go ahead.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.

Q

Yeah. Hi. Good morning John.

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

A

Hey, Dan.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.

Q

The last couple of winters in China, you've seen some pretty significant disruptions in their domestic methanol industry for environmental reasons, natural gas, availability issues et cetera. What's your latest take going into the winter this year about what could potentially transpire in China?

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

A

So here I have to put my weather forecasting hat on, and I'm not very good at forecasting weather like most people around the world. But I think last year we had a pretty cold winter there and certainly they didn't have enough gas imported or domestic to supply all of the needs, forget the industrial complex. So we're monitoring the situation pretty closely here in mid to late October, but we really won't know until December, January when the cold weather kicks in, it'll depend on how cold it is.

Certainly, I think they've taken steps this year to import more LNG. I think the largest import of LNG ahead of Japan now, so they are reacting to what happened last year, but there's certainly not enough gas to satisfy all of the needs of the country, so they're going to have to burn more coal for power and heating. That's our expectation. How much more? It depends on the weather, but we would expect natural gas to be restricted to make methanol in the winter and depending on how much coal they need to burn for electricity and heating could impact the coal-based industries like methanol. So it's bit of a guess depending on how cold the winter is.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.

Q

All right. Thank you. And then you mentioned that there was an Iranian plant that started up in the quarter and is ramping up. Can you just give us your senses of how the moving pieces in Iran work, gas availability versus sanctions? And any sort of latest read on the ability of that to hit the market? Thank you.

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

A

Yeah. Just to remind everybody, we're precluded from going and doing business in Iran. So a lot of our information we get is the public information. What we've seen in the last years is during their wintertime, gas restrictions on the existing methanol production, we're not aware of them having significant infrastructure to gas deliverability improvements over the last 12 months. So if the past is anything like what the present, then we would expect gas restrictions to industry including methanol during their wintertime, but again it's probably dependent on the weather and how cold it is. And the sanctions are going to kick in here in early November and how is that going to impact their ability to move methanol. These are all questions that our teams follow on a daily basis. But until things actually happen, it's a little bit hard to forecast. But we would expect Iranian production of methanol and other products in the wintertime to be somewhat restricted because of gas availability during the wintertime.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thanks, John.

Operator: Thank you. The following question is from Steve Hansen of Raymond James. Please go ahead.

Steve Hansen
Analyst, Raymond James Ltd.

Q

Yeah. Good morning, guys.

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

A

Hi, Steve.

Steve Hansen
Analyst, Raymond James Ltd.

Q

John, just on the idea of a potential partner for G3, you've given us a few details. But just can you give us a bit more sense for how many potential parties you might be speaking with at the moment as you look to sign somebody by year-end? And just as the second part of that, what are the strategic value might you be looking for other than gas which seems an obvious one? Is there marketing relationships, downstream customer demand? And what kind of commitments would you be looking for there if it was something other than gas in terms of from off-take or something thereabouts?

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

A

Well, as you get close to getting married, you don't want to have six or seven partners. So you want to have a couple and then choose. So I'd say we're down to the getting married stage, and we're close to signing the – the heads of agreement which is like a Marriage Certificate on how things will be conducted over the next 25 years. Things we've said that what we're looking for is somebody that has strategic values. So gas, of course, would have a strategic value. Somebody that could possibly take methanol in an off-take through a derivative, so somebody that's producing a derivative somewhere around the world or may be interested in building on our site where we have significant amount of land that we could have derivatives built on the site and somebody that could maybe help us make sure we have access to markets and access to governments at the highest levels.

So those are the kinds of attributes we're looking for in a strategic partner, somebody that understands the business, somebody that is looking to grow their business and somebody that's really wanting to be a partner, but maybe not wanting to operate and understands our efficiencies around Geismar and having us operate could be the right choice for themselves. Those are some of them and each partner has different attributes, but we're getting pretty close here, so you shouldn't expect us to be dancing with about six people, maybe one or two.

Steve Hansen
Analyst, Raymond James Ltd.

Q

Okay. That's helpful. And just a quick follow-up on the Geismar debottleneck. I think you said a 10% capacity increase is what you're shooting for. And I just wanted to clarify, I think you said a few tens of millions of dollars and there was a timeframe that you attached to that as well. But I just wanted to get a bit more clarity on exactly when we should expect that debottleneck to push through?

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

A

Yeah. Few tens of millions of dollars is our current estimate. There's a few things that have to be done. We have to be – this will be like tying in what we did in Medicine Hat a CO_2 stream into the plant. So that could only really be done around turnaround time. So believe it or not, G1 and G2 are coming up for turnarounds over the next few years. It's already been that long. And at the same time, we have to build a pipeline for CO_2 so that would take a bit of time as well. So, all that work is ongoing as we speak. So, as we do turnarounds, we would put the equipment in place to be able to introduce CO_2. And as we complete the pipeline, we would introduce it to G1 and then G2 as we did that turnaround. So that's why we said the next few years. So it's really dependent on the turnaround to tying the equipment and getting that pipeline built.

Steve Hansen
Analyst, Raymond James Ltd.

Q

So just to clarify, it sounds like it's a couple of years out still, it's more like a 2020 or 2021 event?

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

A

We'd want to get that specific depending on the pipeline, and we're doing the work on that right now and that's kind of the – we know when we're going to do the G1 turnaround, we know what we have to do there, but there's a bit of uncertainty on the timing around the pipeline. But it will be staged to G1 and then G2 is how you should think about it.

Steve Hansen
Analyst, Raymond James Ltd.

Q

Understood. Okay. That's helpful. Thanks, guys.

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

A

Yeah.

Operator: Thank you. The following question is from John Roberts of UBS. Please go ahead.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. John, there's a lot of nervousness about the industrial markets recently. Are you seeing anything in the formaldehyde or other chemical derivative markets from ethanol that give you a sense of where the industrial markets are today?

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

A

Yeah. We're seeing strong growth. So yeah, I've read the same stuff you have and heard the same stuff you had. But I can only speak for methanol, we're seeing very, very strong growth. And as we go into the fourth quarter, we're seeing solid growth, the GDP, IP growth on the traditional chemical derivatives and really strong growth on things like MTO, another roughly 8 million tonnes of new MTO production that's based on methanol demand over the next two years to three years, so those are facilities that are under construction. So, we continue to see robust growth on the traditional chemical derivatives and really strong growth on the energy kind of related including MTO.

So we're not seeing the same things that some other companies are seeing, it doesn't mean I won't be talking next quarter and maybe things have changed. But we can only report what we're seeing and we're very involved in China. So we are the largest importer of methanol to China. We have a large team on the ground there. We watch China really, really closely, and we're not seeing anything today that gives us concern.

John Roberts
Analyst, UBS Securities LLC

Q

And then maybe a follow up then on MTO in China. A lot of the MTO in China is for propylene and China also makes propylene from imported propane from the U.S. Do you think MTO during the quarter benefited when the U.S. propane exports stopped at the start of the quarter?

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

A

Yeah. I'll remind you those methanol to propylene plants were shut down in 2016 and never restarted. So, all the plants that are using MTO are both ethylene, propylene sites and they're mainly integrated. So, certainly, if there's less PDH, less propane, maybe a bit more demand for domestic, but these are such integrated plants. It's really you have to look at the derivatives they're producing to really understand the supply-demand balances. So, unless you had a view and we don't have a view that those methanol to propylene on-purpose plants come back, then you might see some impact, but that's not our expectation at this time.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. Thank you.

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

A

Thanks, John.

Operator: Thank you. The following question is from Hassan Ahmed of 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

Hey, Hassan.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

John, question around China. Seemed to be sort of mixed messages coming out of China as it pertains to the whole environmental side of things. One side of the story is that the sort of supervision of these environmental sort of regulations and the like will move from the federal side of things to the provincial side of things which essentially in theory would mean that they become a bit more relaxed. But the flipside of that is, there's also news that that 2 plus 26 may move to another 11 cities, which in theory could mean more curtailment. So what are you guys seeing on the ground over there?

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

A

Yeah, we see the same thing that you mentioned moving to provincial. But we've said directionally, China has been very clear at the central level that they want to reduce emissions, especially particulate matter mainly in the East part of China and that's why we're seeing. That doesn't mean they're going to overnight reduce emissions to zero. They're very serious about cleaning up the air and cleaning up the water and directionally that's what we see. It doesn't mean they won't take certain decisions on a short-term basis, which may be driven by other factors. But directionally we would expect over time less and less coal based industry on the East Coast and certainly less and less methanol being made from natural gas, as they use the natural gas for heating and electricity which is much cleaner burning than coal. So really no change in our thoughts about the direction, although there may be quarters or months where there are other issues that are driving other behaviors.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Understood. Now as a follow-up on the MTO side of things, in the ethylene markets we've obviously seen some choppiness, we had ethane ethanol prices skyrocketing in the U.S. then they've sort of come down a fair bit, obviously oil is up, naphtha is up and then last but not least you have this whole sort of sanctions and trade tariffs and the like coming out of sort of the U.S. and China. I mean with all of this in mind, are you seeing more activity in China on the MTO side? I mean do you feel that now with all of these sort of cross-currents the Chinese may actually go out and sort of start doubling down on the MTO side of things?

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

We've seen some of that for sure. Like I mentioned earlier, over the next two years to three years it's going to be 8 million tonnes more methanol demand for MTO, that's up about 5 million tonnes from my last guidance. But that second wave of 15 million tonnes we haven't seen all of that come under construction yet, but that doesn't mean in this environment, they get a little bit more bullish about that. Naphtha is still fairly competitive even at $600 a tonne, $700 a tonne. I think everybody is in the same position, well, what's oil going to do and therefore what's naphtha going to do and have a huge investment in the naphtha cracker.

And if oil goes back to over $100 a tonne then that investment is probably under water. So everybody is kind of in the same boat. And what's going to happen with oil, with Iran sanctions and things in the Middle East, I don't know, but certainly we've seen it increase here quite substantially in the last two years. So I think it's tough to be making significant investments like naphtha crackers in the current environment and MTO is certainly one that requires a lot less capital and then you just have to have a forecast on your methanol price versus other options. So I think nothing has really changed, but it's a lot harder today I think to pull the trigger on naphtha cracker than it was a few quarters ago.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Understood, very helpful. Thanks so much, John.

Operator: Thank you. The following question is from Nelson Ng of RBC Capital Markets. Please go ahead.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.
Q

Great. Thanks. John, I just want to follow-up about the restrictions in China I believe. I guess there's some talk about relaxing emissions restrictions this winter to kind of help out the domestic economy. I guess first part of the question is, are you hearing the same? And I guess, if there are less restrictions, is it your view that production curtailments will mainly be based on whether it's a cold winter or mild winter?

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

I haven't heard that about relaxing of restrictions. So that's news to me. So I haven't heard that. Depending on what it said and where and how much could impact the shutdowns of some of the coal based industries, but I'm not aware of that at all. And I think I mentioned earlier that the more severe the cold winter is with the more restrictions we would expect.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.
Q

Okay, got it. And then, just one last cleanup question. Regarding the $50 million to $60 million spend on G3. Will it be expensed or capitalized, so just wondering whether we should be reducing it from our EBITDA for the next [indiscernible] (00:34:36)?

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

No, it will be capitalized. Assuming we go forward with the project it'll be capitalized.

Nelson Ng
Analyst, RBC Dominion Securities, Inc.
Q

Okay, great. Thanks.

Operator: Thank you. The following question is from Jonas Oxgaard of Bernstein. Please go ahead.

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

Hi. 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

Could we talk a little bit more about the Iranian sanctions? Like China has – if I understood it correctly, China has already announced that they plan on continue importing methanol. But how does that work with the shippings? Are there shippers willing to ship to China even with the sanctions in place? How should we think about this and how this evolves? And then I have a follow-up.

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

Yeah. I have not heard that China has said that they're going to continue to import methanol from Iran, but I did see this morning as the state-owned companies like PetroChina indicating they haven't booked any cargos for oil in November. So our current view would be, if you have international operations that impact the U.S., you're probably not going to import much of anything from Iran. That doesn't mean nothing will get to China, because there's a lot of companies in China that don't have international operations and probably would feel comfortable in importing methanol and other products into China. We won't know for sure until when the sanctions kick in next week and then we'll certainly monitor it.

The last time, the sanctions were in place, they did have a hard time getting insurance, they had a hard time getting banking, they had a hard time getting shipping, but I think they found ways around all of those and we did see product flow from Iran into India and China. That would be our expectation today, but we wouldn't expect state-owned companies with international operations to be handling much Iranian methanol or oil or other products from Iran. It's our current view, but we're going to watch it like everybody else and see how it evolves.

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

So it sounds like you'd expect some short-term disruption, but not necessarily long-term?

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

That would be our expectation today unless there's more pressure exerted or other things happen. So we would expect India and China to be continuing to import methanol, but not the state-owned companies in China.

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

Okay. And is there any impact on the new projects, they are still coming online?

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

The new projects in the U.S. or the new projects in Iran?

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

Oh, in Iran.

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

Yeah. Again, we don't have a lot of additional information on Iran than anybody else has because we can't go there and we don't go there. So, what we've heard is from catalyst suppliers and shipping companies et cetera that do, do business there that they probably view would be, it's going to be harder to get workers and equipment and spares and catalyst, and like I said shipping and insurance. So, it'll be harder, probably lead to some delays, but we've seen over times when there has been previous sanctions that these projects do proceed and like I said maybe not in the timeline that they originally thought, but eventually they do get completed and that would be our current expectation as well.

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

Okay. Thank you.

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

A

Thank you.

Operator: Thank you. The following question is from Matthew Blair of Tudor, Pickering, Holt. Please go ahead.

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

Q

Good morning, John.

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

A

Good morning.

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

Q

You mentioned that methanol demand was strong in Q3. I was hoping that you could put a specific number on that? I think in the first half of the year, Methanex talked about 4% global demand growth. So, was Q3 in that same range or stronger or weaker?

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

A

Yeah. In that same range. Year-over-year 4% is what we saw. Yeah.

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

Q

Sounds good. And then just circling back to the comment on inventories, year-to-date there's been an inventory draw within your system, but did I hear you correctly that you are looking to significantly build those inventories in Q4?

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

A

Well, significantly is not a word I would use. I'd say throughout the year, we've been trying to build inventories, but we've had really strong sales. And our production has been solid, but maybe a few 100,000 tonnes less than we had forecasted for all the reasons that I have mentioned this quarter and a few other quarters, we had significant complex outage in New Zealand Q2, Q3. And so we've been trying to build throughout the year. So I wouldn't use that word significantly, I had used the word we'd like to have our inventories grow at the same percent as our sales. So we've grown our sales by 1 million tonnes, and probably 100,000 tonnes in the inventory is like what we'd like to see it grow by.

We haven't been able to do that as you pointed out. So we're going to continue to try, but I'll tell you it's very tight out there. We're having a hard time finding product that at any price. So whether we're successful or not depends on the supply/demand balances around the world. So we're not comfortable with our current inventory level with 11 million tonnes of sales and we're going to continue to be aggressive in trying to get it to that 1.1 million tonnes and slightly higher. So we're going to continue to try and do that and we're hoping for a real solid production quarter from our assets, like I said earlier are really unknown is the gas supply in New Zealand. So we'll see how that turns out.

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

Q

Very helpful. Thank you.

Operator: Thank you. The following question is from Charles Neivert of Cowen. Please go ahead.

Charles Neivert
Analyst, Cowen & Co. LLC

Q

Good morning, guys. Just had one quick one. Are you seeing the continuing increase in methanol use in the industrial boilers, so are they moving in that direction and do you think there's going to be a bit of an acceleration as you move into the winter as again they discourage the use of coal and things of that nature? And where would you put the current demand at the industrial boiler level now? And again do we think it's going to go up during the course of the winter?

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

A

Yeah, it's not really seasonal, Charlie. I mean once they make the conversion, the conversion is done. So it's not really a seasonal demand, it's like when you're choosing to get out of coal for boilers, you can use diesel, methanol or natural gas, and all three are being chosen. It's just around 2 million tonnes now, so we are continuing to see growth in that market. We're doing a lot of work in China with the government on standards and specifications and delivery and all of that work has gone really well. So that's been very positive for the industry as well as the methanol boiler manufacturers, who used to make coal boilers as well. So it's headed in the right direction. But I'll reinforce its not seasonal, once somebody decides...

Charles Neivert
Analyst, Cowen & Co. LLC

Q

Yeah.

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

A

... to switch, they're not going to switch back, and it's not really...

Charles Neivert
Analyst, Cowen & Co. LLC

Q

Yeah. No, I didn't mean to imply their seasonality, it was just whether it's a continuing thing ...

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

A

Yeah.

Charles Neivert
Analyst, Cowen & Co. LLC

Q

...and when they push to get the coal out for environmental. So...

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

Yeah, that ...

Charles Neivert
Analyst, Cowen & Co. LLC
Q

... that's continuing to be the case.

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

Yeah, that trend is continuing, we would expect it to continue to accelerate. One of the new ones – and one of the – we had one of our Chinese team members here last week in Vancouver, and she brought me a piece of pottery made in a methanol kiln which was pretty cool. So we haven't talked about kilns yet, but that's another very large potential demand for methanol. So they are starting to convert kilns from coal to methanol, and I've got one on my desk, so it's kind of a nice little milestone that we haven't talked about yet, but stay tuned.

Charles Neivert
Analyst, Cowen & Co. LLC
Q

Okay. And one other question on – I know that there has been over time some increasing use of methanol as a cooking fuel. Is that something that's also continuing? And why would you sort of [indiscernible] (00:42:48) at current levels?

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

It's not really a big demand driver about 1 million tonnes. We don't see huge growth there, but it's been pretty stable.

Charles Neivert
Analyst, Cowen & Co. LLC
Q

Okay, thanks very much.

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

Thanks, Charlie.

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

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

Hey. Good morning, everyone. How are you doing?

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

Hey, Chris.

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

Q

You've mentioned the potential demand for the next few years from new MTO plants, I think around 8 million tonnes. Can you contrast that with what you see for the supply coming online for the next few years, you must have some insight as to what's there, and is it most of that coming out of Iran?

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

A

Yeah, that's a good point. There is some additional supply expected out of Iran, a couple of more million tonnes beyond what's under production right now. Towards the end of the decade into the next decade probably the Trinidad, Mitsubishi plant will start up, that's about 1 million tonnes and then we have [indiscernible] (00:43:55) plant in the U.S. they've just signed some sort of partnership deal with Coke. We don't have the details of that, but that's probably 2021-ish, 2022-ish kind of timeframe and that's about 1.8 million tonnes and then some small more production coming out of China, but we do expect as I mentioned earlier some rationalization in China as well.

So, yeah, you're right to point out, there's quite a bit more demand coming on than supply and we can't build it all ourselves and we do need to see some additional supply to keep the world balance. So it will be really interesting in the next couple of years and we'll see how these projects that are under construction get completed and run. But we're going to need quite a bit of new methanol supply to meet this demand.

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

Q

And then just to clarify, did you say you guys expected production to be up sequentially in the fourth quarter?

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

A

I said it will be up from the third quarter, yes.

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

Q

Even that's taking into consideration the turnaround that you suggest that will be happening in 4Q?

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

A

That's right.

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

Q

Okay great. Thanks a lot.

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

A

Thank you.

Operator: Thank you. And we do have a question from Cherilyn Radbourne of TD Securities. Please go ahead.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Thanks very much for squeezing me in. Just had a...

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

A

No problem.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Had a couple of quick ones on South America. First off, on Chile, just want to make sure that I understand the plan there. Is your intention to run both Chile I and Chile IV together for some period of time before taking Chile I down for refurbishment or what's the plans there?

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

A

Yes, our plan is to ramp up both plants to full rates as soon as we can. That's the plan. Gas is available, and we're ramping up Chile IV as I mentioned earlier. And I'll remind you Chile I hasn't run at full rates for quite a long time. So current plan would be to ramp up Chile IV stabilize it, and then to slowly ramp up Chile I. And whether we get to full rates or not, yeah, we think we can, but maybe it's 90% we don't know because we haven't run it at full rates for some time. Assuming we secure additional gas, our plan would be to take Chile I down during their southern hemisphere winter time to do refurb – about a half of the $50 million refurbishment. And assuming, we can secure additional gas, we would do the second half of that refurbishment in mid-2020. But during the non-winter months down there, our plan is to run both plants at full rates and there's enough gas today to do that. So again, we're not going to spend the money in Chile I until we secure additional contracted gas to underpin that plant for some more years.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

And then, as it relates to Argentina, obviously, there's been some political turmoil in that country recently. Are you continuing to see investment in the [indiscernible] (00:46:52)?

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

A

Absolutely. I mean I think part of their solution is to become self-sufficient in energy and that's their focus, so they don't import LNG and gas from Bolivia et cetera, which they have to pay for in U.S. dollars. So it's strategic for the country to get sufficient and then to start exporting again. I think that's their goal. So lots of reserves there, there's been lots of work done and they're pretty close to back to the production levels they were pre-2007 and they've been very clear during their summer months when they have excess gas, they will be looking to export that gas to us and to others.

I think over time as they become more self-sufficient, we would expect them to build infrastructure to allow them to export gas in the form of LNG, that's somewhere down the road, but certainly, there's a lot of gas in that formation, the EIA says 800 tcf and they're applying the same technology to that base and that we've seen applied in Chile and of course, in North America. So lots of activity and going quite quickly and we're quite optimistic they'll become self-sufficient and even one day in their wintertime will start to get gas, but I think that's a number of years down the road.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Great. Thank you for the time.

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'll turn the meeting back over to Ms. Campbell (sic) [Mr. Floren] (00:49:01).

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Okay. Thank you. I'm thrilled with our 2018 performance to-date as we've generated record adjusted EBITDA in the first nine months of the year, as a result of the investments we have made to grow the production capability and earnings power of our company. Our balanced approach to capital allocation remains unchanged. Our priorities are to meet our financial commitments, pursue our value adding growth opportunities and return excess cash to shareholders through dividends and share repurchases. Thank you for the interest in our company.

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