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Methanex Corp. (MEOH)

Q2 2020 Earnings Call

CORPORATE PARTICIPANTS

Kim Campbell
Director, Investor Relations, Methanex Corp.

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

Ian P. Cameron
Chief Financial Officer & Senior Vice President, Finance, Methanex Corp.

OTHER PARTICIPANTS

Jacob Bout
Analyst, CIBC World Markets, Inc.

Ben Isaacson
Analyst, Scotia Capital, Inc.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Michael Leithead
Analyst, Barclays Capital, Inc.

John Roberts
Analyst, UBS Securities LLC

Steven Hansen
Analyst, Raymond James Ltd.

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

Nelson Ng
Analyst, RBC Capital Markets

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: All participants, please standby. The conference is ready to begin. Ladies and gentlemen, thank you for standing by. Welcome to Methanex Corporation Q2 2020 Earnings Call.

I will now turn the meeting over to Ms. Campbell. Please go ahead, Ms. Campbell.

Kim Campbell

Director, Investor Relations, Methanex Corp.

Thank you. Good morning, everyone. Welcome to our second quarter 2020 results conference call. Our 2020 second 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 conclusion or making the forecast or projections which are included in the forward-looking information. Please refer to our second quarter 2020 MD&A and to our 2019 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 to 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 period.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Good morning. We hope everyone is continuing to stay safe and healthy. We will start with a few comments about the current environment and then speak to our Q2 results, provide an overview of the methanol market and discuss how we are managing our business in this challenging environment while positioning ourselves to benefit from the recovery in the global economy.

Our number one priority remains the safety of her employees, contractors and communities where we work, and we are thankful that our team is safe and healthy. We continue to evaluate the risk at each of our locations to ensure the safety of our team members, and we continue to take extensive health and safety measures across our operations and offices as we begin to return to our workplaces at most of our locations.

We have again demonstrated the resilience of our business model as our operations and global supply chain continue to run effectively in a different, very difficult environment and our ability to service customers has not been significantly impacted by the pandemic. A big thank you to the entire team for a job well done.

Now, turning to our second quarter results. This is a very challenging quarter for the methanol industry and our company. Due to the impact of COVID-19 and low oil prices, we recorded adjusted EBITDA of $32 million and an adjusted net loss of $64 million or $0.84 per share. Our results were significantly lower compared to our first quarter due to a lower average realized price and lower sales volume, which were partly offset by lower production and selling, general and administration costs.

Also, our margins tend to be lower in the declining price environment compared to a stable price environment. Generally, the opposite applies when methanol prices are rising. We estimate that inventory timing differences reduced adjusted EBITDA by approximately $25 million in the quarter. We estimate global methanol demand declined by approximately 5% or 1 million tonne in the second quarter of 2020 compared to the first quarter, reflecting significant declines in most parts of the world outside China.

The demand impact in China resulting from manufacturing shutdowns due to COVID-19 was felt the most in the first quarter. If we compare the second quarter of 2020 to the fourth quarter of 2019, we will see the full impact of COVID-19 where we estimate that quarterly global methanol demand declined by approximately 12% or 2.5 million tonnes. Prior to COVID-19, annual methanol demand was expected to increase by 3% to 4%, or approximately 3 million tonnes in 2020 compared to 2019.

In China, methanol demand increased by approximately 4% in the second quarter of 2020 versus the first quarter, as economic activity began to recover from seasonally lower levels and COVID-19 impacts. Ground transportation increased and fuel demand improved. Methanol demand improved across both traditional chemical applications such as formaldehyde and energy-related applications such as MTBE, DME and other fuel applications.

Methanol-to-olefin demand was particularly strong as several plants restarted and maintained high operating rates following planned and unplanned outages in the first quarter and supported by a significant improvement in ethylene pricing in the second quarter.

Outside of China, methanol demand declined by approximately 19% quarter-over-quarter. Traditional chemical demand declined due to significantly lower manufacturing activity, particularly in the automotive and construction markets, which are both major consumers of methanol. Demand into energy-related applications, including MTBE, declined due to reduced ground transportation and fuel demand.

Global methanol industry supply also declined in the second quarter of 2020 compared to the first quarter due to various outages and shutdowns around the world, but not quickly enough to offset the global decline in methanol demand which led to prices falling below the cost curve in Q2.

As we've previously announced, we idled our Titan plant in Trinidad in mid-March and our Chile IV plant as of April 1. We have seen other producers in Trinidad, Argentina, The Netherlands, Russia, and China reduce operating rates or shut down. We'd estimate that global methanol supply declined by approximately 9% when comparing the second quarter of 2020 to the fourth quarter of 2019. Overall, production in the second quarter was 379,000 tonnes lower than the first quarter of 2020, primarily due to the idling of our Titan and Chile IV facilities.

Early in the third quarter of 2020, improving methanol demand and methanol plant outages in Southeast Asia and the Middle East have impacted market conditions and provided support for higher methanol prices. We estimate that the industry cost curve, which continues to be set in China, was approximately $200 to $220 per tonne.

Spot prices in China are marginally below the cost curve today. We recently posted our August North American price which remained at $276 per tonne, and our Asia-Pacific price which increased by 14% to $245 per tonne. Our European contract price is set quarterly and our third quarter posted price of €235 per tonne.

We believe that the outlook over the coming months remains uncertain and it's difficult to predict the full impact of COVID-19 pandemic and the lower oil price environment on methanol demand. As previously announced, we have taken several steps to further strengthen our balance sheet and preserve liquidity, including deferring approximately $500 million in capital spending on the Geismar 3 project for up to 18 months, reducing our quarterly dividends will result in approximately $100 million in annualized cash savings, and reduced 2020 maintenance capital spending by $30 million.

As you are aware, our cost structure moves with the price of methanol. The price we pay for approximately 60% of our natural gas we consume, which is our most significant operating cost, is linked to methanol prices. This means that our operating cost move up – move down as methanol prices decline, although there is a time lag of up to one quarter.

We expect that a lower oil price environment will offset our previously anticipated increase in shipping costs due to the new International Maritime Organization's 2020 regulations. We also continue to actively manage our operating cost across the organization during the current downturn due to COVID-19. We have a strong liquidity position and ended the quarter with nearly $800 million in cash on the balance sheet.

We expect that we only need to maintain a minimum cash balance of approximately $150 million to run the business day to day. We have no near-term debt maturities. We also recently announced that we amended our $300 million committed revolving credit facility and $800 million non-revolving construction facility, which provides meaningful financial covenant relief.

As we previously announced, we've placed our Geismar 3 project on temporary care and maintenance. Prior to making this decision, the project had been significantly de-risked and our project execution was safe, on time and on budget. We will consider a number of factors before deciding on whether to restart the project, including the pace of the global economic recovery, methanol market conditions, our ability to effectively finance the project, and the ability for suppliers to execute construction and to deliver material and equipment.

Given the uncertainty in the broader economic environment due to COVID-19, we continue to plan for a wide range of scenarios, including ones where we see a more prolonged period of lower methanol demand and continued bottom cycle pricing.

We are focused on cash preservation and continue to evaluate all options to ensure we maintain financial capacity and flexibly to navigate the current environment and emerge stronger over the cycle as conditions improve. We will not undertake share buybacks in this environment as any excess cash will be used to further strengthen our balance sheet.

Now, turning to our outlook for the third quarter. We expect the outlook over the near term to be uncertain and we cannot predict the full impact of the COVID-19 pandemic and lower oil price environment on the methanol market. While we have seen higher methanol pricing in the recent weeks, based on our posted methanol prices so far this quarter, we expect average realized prices in the third quarter to be similar to the second quarter. We expect our production levels in the third quarter to be lower than the second quarter.

However, as prices stabilize, we expect that the timing differences due to our FIFO, first in first out, inventory accounting will have less of an impact on costs. We expect adjusted EBITDA to be similar in the third quarter compared to the second quarter.

Before passing for questions, we'd like to highlight a couple of points regarding the resilience of our business. While the near-term outlook is uncertain, we expect continued long-term demand growth for methanol. Methanol is a key ingredient that serves as a building block to produce a multitude of everyday items used to construct and insulate our homes and automotive components to make cars lighter and in the technology that keeps us connected.

In many cases, there are limited, if any cost, effective substitutes for methanol in many of these applications. Methanol is also used in an increasing number of energy-related applications, and is a clean burning and economic alternative fuel. Demand for methanol will eventually rebound as global economic activity recovers.

As the industry leader with a global production footprint, integrated global supply chain and low cost structure, we have continued to deliver secure and reliable supply of our customers globally, which is our competitive advantage, enabled us to be the supplier of choice to customers around the world.

Our production assets are well positioned on the industry cost curve to be competitive through the methanol price cycle. We have a strong cash flow potential with significant leverage to methanol prices. We estimate that every $10 change in our average realized methanol price results in approximately $60 million increase to adjusted EBITDA on an annual basis.

Finally, we have unique growth opportunities in Louisiana, allowing us to increase our production capacity at advantaged capital cost, when conditions improve to enhance our global leadership position and create significant shareholder value in the stronger global economic environment.

We remain focused on operating our plants safely and reliably, delivering secure and reliable supply to our customers, and protecting our balance sheet. We believe that our resilient business model and strong liquidity position will enable us to navigate this challenging environment and position ourselves to generate significant long-term value as global market conditions recover.

We will now be happy to answer any questions.

QUESTION AND ANSWER SECTION

Operator: Perfect. Thank you. We will now take questions from the telephone lines. [Operator Instructions] The first question is from Jacob Bout. Your line is open. Please go ahead.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Hi. Good morning.

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

A

Good morning.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Once you're off on G3 and maybe you can just talk about your ability to push that out further than the 18 months, later than 2021 and any financial penalties to do so?

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

A

Yes, when we renegotiated our recent revolvers and including the construction facility, we did get some relief on the completion date for G3. So, we have pushed that out a little farther.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

How far out?

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

A

Another 12 months.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Okay. And then can you just talk about the incremental cost, if any, from COVID-specific events in the quarter?

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

A

A very minor incremental cost really to do with working remotely, some technology probably, but very, very insignificant.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Okay. And then just last question here global methanol demand. So, you gave numbers of ex-China down 19% in second quarter. Be interested in hearing on how things actually improved through the quarter and what July is looking like?

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

A

Yes. I think it's difficult to predict demand in this environment, Jacob. We'll continue to watch it, but I'd say outside China we're still seeing significant pressure on downstream end use products and demand is slow to recover. So, we'll continue to watch it, but I think it's too early to predict demand recovery.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Were things significantly worse in April than June?

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

A

I don't want to go month-by-month because it's better to look at quarter-by-quarter, but I'd say demand is still significantly down from where it was Q4 2019.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

All right. I leave it there. Thank you, John.

Operator: Thank you. The next question is from Ben Isaacson. Your line is open. Please go ahead.

Ben Isaacson
Analyst, Scotia Capital, Inc.

Q

Good morning. Thank you. John, we've read that inventory levels at Chinese ports are reportedly high. Can you kind of put that into context as to how you see global inventory levels through the channel?

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

A

China levels continue to go up and sort of the demand is quite a bit higher because of MTO operating in China. And we've said before that we haven't seen the terminal capacity increase in China to the extent that it needs to accommodate for the new demand on the coast.

So we would characterize inventory levels today probably more normal than high. I'd say they were certainly high as we entered the quarter with all the uncertainty. India basically shutting down, so most of the Iranian production ended up in China, which led to higher inventory levels. Globally, including our own levels, we wouldn't characterize as inventory levels as high, but more I would say normal.

Ben Isaacson
Analyst, Scotia Capital, Inc.

Q

Celanese stated yesterday that they see global acetic acid inventories as being low. Do you think that's a meaningful tailwind to reduce methanol inventories?

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

A

Well, acetic acid of the chemical demand, I think, is about 9%. So, we'll take any new demand we can get versus where we've been. But, I don't think it's – even if it goes up by double digit, it's not going to have a significant impact on the overall methanol supply-demand balance.

Ben Isaacson
Analyst, Scotia Capital, Inc.

Q

And my last question is, you realized $8 million in savings in Q2 versus Q1. How much of that do you think is sustainable on a run rate basis going forward?

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

A

Well, I guess it depends on how COVID-19 continues to impact our ability to do things like travel and our company is set up as a collaborative-type company. We have a lot of global teams that meet on a regular basis. And all of that, obviously, has ended. And obviously, this environment, when we're looking at hiring and things like that, we're being very cautious.

And to me, I think the question is, what is the longer-term or medium-term demand for methanol? We were setting up the company to be growing in line with the methanol market, which was 4% to 5%. And obviously, that's totally changed right now.

So, we may need fewer people going forward if we don't see a rebound in methanol demand. And if we do, then, obviously we'll adjust our cost structure as a result. So, I'd say the savings that we've achieved are maintain them – we can maintain them in the current environment.

Ben Isaacson
Analyst, Scotia Capital, Inc.

Q

Okay. Thank you very much.

Operator: Thank you. The next question is from Joel Jackson. Your line is open. Please go ahead.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Q

Hi. Good morning, John.

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

A

Good morning.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Q

I have a few questions. So, the first one would be, if I heard your data point correctly in the prepared remarks, you talked about methanol market contracting about 12% between Q4 of 2019 and the second quarter. It looks like your own sales volumes contracted between 16% and 19% between Q2 and then Q4.

So, looks like you lagged, you had worst contraction in the industry, can you talk about that? Was that a strategic choice to help balance supply and demand? You had some plants that closed as part of that as well, maybe you can just talk about that, please.

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

A

Yes, it's not a strategic choice to not sell product. We sold all the product we could. Certainly, we took plants offline to get in front of what we saw declining demand environment, which proved to be quite a good call in retrospect. And the only plants where we had total flexibility was Chile IV and Titan, and that's why we chose those plants.

If you look at the impact on us, we're underweighted in China versus the rest of the world. China recovered in Q2 while the rest of the world declined 19%. Our larger exposure to Asia Pacific, Europe and North America saw us decline more in Q2 than the market. So, that's not unexpected based on our mix.

And MTO saw a growth in Q2 and high operating rates. And we have less supply in MTO in Q2 as they, I think switched to buy more Iranian product that was being sold at a discount in China by up to $50 a ton during the quarter. So, we would have not chosen to compete at some of those MTO accounts at those price levels. So, we chose not to sell. But we sold everything that we could that made sense for us.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Q

Okay, that's helpful. I had a question about turnaround. You talked about having some maintenance outages at both G1 and G2 in the second quarter. I believe did a turnaround at G1 last year, maybe G2 was due. Does this mean you don't need to do a turnaround at either G1 or G2 in the next couple of years? And then, do you have any other turnarounds planned – any other plans this year?

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

A

Yes. With G1, usually we get four years between turnarounds, and so we did G1. And so I don't expect to do a turnaround at G1 for three years. As far as G2, it hasn't had a turnaround yet since it started and you can do the math, Joel, it's coming up to four years. So, I think that'll be due at some point, not too distant future.

The outages we took in Q2 were really minor maintenance outages. I mean, pricing was low, demand was poor. So, we just took advantage of those conditions to make some minor corrections, to make those plants safer and more reliable over the medium-term.

We've always guided to two to three turnarounds per year. Obviously, in the COVID-19 environment, we had to delay some of our planned turnarounds at some of our plants. And assuming everything remains the way it is today, which is a big assumption, we plan to do those turnarounds in the second half of the year. But we're monitoring the spread of COVID and our ability to get these turnarounds done safely and effectively in the current environment.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Q

That's helpful. And just finally, so you talked about the set of conditions you'll be looking at, whether it's to restart G3 in 14 or 15 months. Let's just say that you come to a conclusion maybe around now, that you know what, you're not going to pursue G3 anymore.

I'm sure you've gone back to look at your options here if you were to stop the project and penalties or how much payment you have to make, or what do you want to finish just to have ready for – to restart the project down the road. Can you maybe just talk about as much as you can what flexibility, what options you have, how much you have to spend, what the penalties might be if you stop G3 now?

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

A

Yes, I think it's early. And we've said that to stop it when we made the decision just a quarter ago or to put it on care maintenance is about the same and we haven't changed our view on that.

As we've announced that, we're obviously negotiating with all of our suppliers and different equipment, different construction labor, engineering, et cetera, et cetera on all these different components.

I would also say we've had a number of equipment suppliers declare force majeure on us or interrupted because of COVID-19. So, there's hundreds and hundreds of these contracts that are being negotiated back and forth. So, if we make the decision to not go forward with G3 sometime middle next year, we'll certainly highlight those costs that we would incur at that time.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Q

Thank you.

Operator: Thank you. The next question is from Hassan Ahmed. Your line is open. 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

Good morning, Hassan.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

John, if I heard you correctly, you talked about relative to end of last year's supply being down roughly 9%. So, my question to you is that, with the economics looking the way they are right now, I mean could you venture a guess as to what percentage of that 9% will maybe potentially be permanently sort of curtailed, or do you think most of that supply is going to come online? And then part and parcel with that, how are you thinking about the pace of near-term new capacity additions?

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

A

Yes. So, we've highlighted two plants that we expected to be completed sometime this year. The Yuhuang plant in the United States and the Mitsubishi plant in Trinidad. I think they total about $2.8 million. I think, both are probably under some challenges in the current environment based on our experience with labor availability and how you have to manage your workforce in this type of environment. So, we think they'll start. They will start at some point, possibly delayed. But, it's really hard for me to give you an exact on that, Hassan.

As far as, methanol supply that's offline, gone forever, we think it's hard to predict. You know what we are going through in Trinidad and our competitor has five plants there and the gas dynamics are really difficult. So they've shut down some capacity, and whether that it comes back or not, I think will be a factor of gas price, and whether we and they can negotiate a gas price that makes sense through all points of the cycle of methanol.

So, I think we'll have to watch that and see how that evolves. But it's really hard to predict where that's going to end up. I think in other parts of the world, if pricing was to rebound to more normal methanol cycle levels, mid-300s, we would expect that supply to come back on.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Very fair. And as a follow-up, John, maybe early days, but a lot of sort of news releases coming out about flooding at the Yangtze River. So, what are you guys hearing in terms of, be it methanol output, as well as methanol trade that may or may not get impacted by this flooding that may or may not get impacted by this flooding that's being reported in the press.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes, I don't have anything to add on to that, Hassan, sorry.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Okay. Fair enough. Thanks so much, John.

Operator: Thank you. The next question is from Mike Leithead. Your line is open. Please go ahead.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning, John.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Good morning.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

I have just two kind of higher level questions today. First, I believe Methanex owns its own vessel fleet that I think is worth, call it, roughly $200 million on your balance sheet today. Curious, as you think about improving your financial flexibility in this environment, if you'd consider some sort of sale leaseback arrangement to help generate cash flow near-term, or you would consider owning your own ships strategically important to where you are today with Methanex?

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

A

Yes. Mike, we don't own them all. We have a combination of long-term time charters, which will be 15 years. Some we own in partnership and some we have COAs or Contract of Affreightment. So, there's a mix there. I'd say whether we own them or not is not crucial to Waterfront Shipping. We started owning a few vessels just to understand more around the operations. Obviously, we wanted to promote methanol as alternative fuel.

So, there were some strategic reasons. It's an integral part of our overall supply chain. Our competitive advantage is to secure reliable supply to our customers, and Waterfront Shipping is a key component of that. But I've said earlier, all options are on the table, but we want to preserve our balance sheet and enhance liquidity, but not destroy the future of the company at the same time.

So, I think these things will be ordered and we'll – and the ability to execute is also in this environment of selling assets could be quite challenging in this environment. So, there's a number of factors but we'll consider everything to protect our balance sheet and to enhance liquidity going forward.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. And then second question on the energy opportunity for methanol. I think there's been a lot of talk in investment in recent months around clean hydrogen. And earlier this month, there's a major hydrogen project announced in the Middle East where effectively they're using ammonia as a transport medium to take the hydrogen to the end market.

My understanding is someone could do something similar with methanol as a liquid hydrogen carrier for fuel cells. So, I guess just between what's going on in clean hydrogen or even just direct fuel blending, can you just maybe update us on your thoughts on how you see methanol playing a part in this move towards clean fuel?

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

A

Yes, well methanol has always been a great hydrogen carrier. That's not news. We had a fuel cells project team going back 20 years ago working with people like Ballard for example. And that continues to go forward, not for automobiles in a big way, but for those smaller applications like generators and etcetera.

So, still a very small part of overall demand, but as a hydrogen carrier, methanol is a great alternative. I'd say that kind of application is really a medium to longer term to build out the infrastructure, et cetera. So, certainly possible, but as far as impacting demand in the next five years, I would expect not.

Operator: Perfect. Thank you. The next question is from John Roberts. Your line is open. Please go ahead.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. I think it sounded like you were also curtailing New Zealand a little bit going forward in the back half of the year. Could you give us an update there?

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

A

No, we're not curtailing New Zealand at all. I think I guided last year that we expected our production to be 1.8 million tonnes in New Zealand for the three plants based on gas availability in the country for 2020. We haven't changed that guidance at this time.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. And I think there's been a shortage of plywood in particleboard. Is formaldehyde at least a bright spot in the methanol market?

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

A

Yes, I know there's a shortage from – not formaldehyde, but plywood in particleboard, and I think that's more of a factor of makers of those products to curtail production in the second quarter as well.

And for reasons that we think the renovation market is doing quite well, as people are hunkered down at home and trying to make their spaces more palatable as they have to be there all the time that that's creating a short-term demand for those products, which is good for formaldehyde resins absolutely.

But again, the amount of formaldehyde resin that goes into plywood in North America while interesting, it's not going to move the needle from a demand point of view.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you.

Operator: Thank you. The next question is from Steve Hansen. Your line is open. Please go ahead.

Steven Hansen
Analyst, Raymond James Ltd.

Q

Yes. Good morning, guys. Just a couple of quick operational ones, John, if I may. Just firstly on the maintenance schedule going forward. I know you're taking down maintenance capital for a year.

Just give us a sense for how much more flexibility there might be in that budget and whether you have any major turnarounds planned through the balance of the year. I know you don't give specific timing on those downtimes, so just trying to get a sense for whether we should expect any more disruptions.

And then just a follow-up note or question just on the CO_2 levels that I think you noted in New Zealand. Just trying to get a sense for what's happening there.

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

A

Yes. So, as far as turnarounds, we've guided to two to three per year. Obviously, in the environment we found ourselves in the first half of this year, we couldn't do any turnaround. So, assuming conditions remain similar to how they are today, we'll proceed with our planned turnarounds for 2020.

And we're going to obviously practice all of these safety things that we need to do today in social distancing, et cetera, et cetera, as we do these turnarounds. There's a bit of room maybe to push them up a little bit if we need to because we can't conclude them safely. But there's limited ability to do so.

These are statutory turnarounds that we need to change catalyst and do some maintenance work every three to four years. So, we have limited ability to further postpone these turnarounds, and so, that you should expect us to do two to three a year in a normal environment.

And I didn't really understand the CO2 question related to New Zealand. Are you talking about the high CO2 gas or CO2 emissions in the country?

Steven Hansen
Analyst, Raymond James Ltd.
Q

There was just a very brief comment in the MD&A about CO2 levels being slightly down. I wasn't too sure what that meant. I think it referred to the CO2 gas.

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

That was Medicine Hat, Steve.

Steven Hansen
Analyst, Raymond James Ltd.
Q

Oh, I apologize for that.

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

So we take – yes we take CO2 across the fence from a nitrogen plant. And we have min max rates in that and we decided to go to minimum rates on the CO2 we were taking which impacted our production there a little bit.

Steven Hansen
Analyst, Raymond James Ltd.
Q

Understood. And then just one follow-up if I may is on Trinidad. Where are we at with the broader Trinidad discussion and debates? We all know the backup there, but just trying to get a sense for how that broader discussion or negotiation is ongoing there in the country? What we can expect through the next 12 to 24 months? Hello?

Operator: We are sorry for the delay. We are currently experiencing technical difficulties. The conference will resume momentarily. Thank you for standing by.

All participants please standby, the conference will resume momentarily. Once again, please continue to standby and we thank you for your patience.

[Technical Difficulty] (37:03-38:20)

Operator: We are sorry for the delay. We are currently experiencing technical difficulties. The conference will resume momentarily. Thank you for standing by.

[Technical Difficulty] (38:28-39:42)

Operator: All participants please continue to stand by. The conference will resume momentarily. Thank you for standing by.

[Technical Difficulty] (39:48-40:40)

Operator: We are sorry for the delay. The conference will resume momentarily. Thank you for standing by.

[Technical Difficulty] (40:45-42:00)

Operator: Mr. Floren, this is the operator. Can you hear us?

Kim Campbell
Director, Investor Relations, Methanex Corp.

A

Hello? Methanex Corporation is here.

Operator: Perfect. Thank you. We are now ready to resume the conference. Mr. Steve Hansen, you can repeat your question. Please go ahead. Your line is open.

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

A

Steve, are you there?

Steven Hansen
Analyst, Raymond James Ltd.

Q

Yes. Hey, guys.

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

A

Hi, Steve.

Steven Hansen
Analyst, Raymond James Ltd.

Q

Thanks. I didn't mean to break the call. I apologize. The question is really...

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

A

[indiscernible] (42:39).

Steven Hansen
Analyst, Raymond James Ltd.
Q

...in the background there...

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

[indiscernible] (42:41).

Steven Hansen
Analyst, Raymond James Ltd.
Q

You get – if you didn't hear it, I think we're all familiar with the background. But I just wanted to get a sense for the status of negotiations with the government there...

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

Yes.

Steven Hansen
Analyst, Raymond James Ltd.
Q

...on gas supply. Thanks.

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

Yes. So, we're negotiating, as we said, and we're looking to secure an arrangement that allows us to be somewhat profitable at all points of the cycle. And certainly, the NGC understands that and they're working hard to create the conditions to allow us to sign a deal with them that makes sense for us, makes sense for them and makes sense for the upstream.

So, we have nothing to report today, but we will continue to negotiate. And we're not alone. I mean, there's others on the island, in our business, in methanol, as well as in fertilizer that are in the same conditions that we are. So, I think the government wants to have a solution to this issue and are working hard to make things happen to allow the island to continue to be a significant producer of methanol and ammonia.

And again, we'll report as we have something to report. But right now, the plant is down, and you should expect it to come up here in the near term.

Steven Hansen
Analyst, Raymond James Ltd.
Q

Okay. Much appreciated. Thanks, guys.

Operator: Perfect. Thank you. The next question is from Matthew Blair. Your line is open. Please go ahead.

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

Hey, good morning, John. I was hoping you can provide just a general update on what you're seeing with MTO. There's been some chatter recently that MTO really suffers in a low crude price environment. What kind of operates did you see in MTO both in Q2 as well as currently?

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

A

Yes, quite high. I mean, it was one of the bright spots in the whole methanol demand environment in Q2. So, we saw increasing rates of production as we had new plants year-over-year operating. We did see low pricing for ethylene and propylene, which could have impacted the demand, but we didn't see anybody turn off for economic reasons. So, I'd say MTO continues to operate in that 90% range.

We understand recently that one or two plants are doing some maintenance. One maybe planned; one maybe unplanned. But the number of plants is pretty good, and 80% to 90% going forward and year-over-year, that gives us more demand because these plants weren't running all of 2019.

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

Q

Sounds good. And then the discount rate on the methanol contracts was quite high in Q2. I think you referenced just falling methanol prices as the driver there. With methanol stabilizing, do you see that Q3 discount rate getting closer to kind of like a long-term normalized level around 15% or so?

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

A

Yes, what we've guided to when prizes are increasing, the discount will go down a bit. When prices are decreasing rapidly like we saw in Q2, discount will go up. [ph] In fact (45:48) our highest discount since the financial crisis, when's the last time we had pricing of this order of magnitude. Yes, but our guidance is still applicable in a stable environment where prices are flat, we should experience around 15% discount. And Q3 might be a little higher than that. It's early days, but that's still our guidance.

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

Q

Thank you.

Operator: Thank you. The next question is from [ph] Roger Spitz (46:20). Your line is open. Please go ahead.

Q

Thanks very much. Just on that MTO, a large chemical company on their Q2 earnings call claimed MTO isn't profitable below $50 a barrel. It's no doubt more complicated by that. You have said clearly the MTO guys were operating at 90% just a moment ago. Do you have – I don't know how you feel about this $50 a barrel, but do you have a level where you think it isn't unprofitable or a way to think whether -- when it does become unprofitable?

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

A

Yes. Again, I've said this many times, each site is a little different. And when you calculate profitability for MTO, you've got to look at all the derivatives that are producing at any given site. It's not so much the oil price; it's more of the ethylene and the propylene prices. And for oil and therefore naphtha to substitute, you'd have to have excess capacity of naphtha in order to do that, which is not there today.

So, we've said clearly that growth in olefins is probably going to be in the form of ethane and naphtha in today's environment and not so much MTO, and that's what we're planning for. But the existing capacity will continue to run, provided that they're cash positive on a site by site basis and that's the case today, and that's why we see them running at high rates.

To make a prediction on the future, you'll have to tell me what the ethylene, the propylene and all the derivative prices will be, and then we could calculate the affordability for each and every site. So, I think it's a pretty basic analysis to say $50 oil below, they're all going to turn off. And I think history would show that's not the case.

Q

All right, thank you very much.

Operator: Thank you. The next question is from Nelson Ng. Your line is open. Please go ahead.

Nelson Ng
Analyst, RBC Capital Markets

Q

Great. Thanks. My first question just relates to the working capital. I know that in Q2, there's a big positive working capital move. I know $60 million of that was due to the insurance proceeds from Egypt. But can you give a bit more color as to whether that will or whether a lot of that will reverse in the coming quarters or whether some of that's permanent?

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

A

I hope it does. It means we've got higher methanol prices. So, I'm cheering for the working capital draw to reverse.

Nelson Ng
Analyst, RBC Capital Markets

Q

So, most of that is just due to methanol – driven by methanol prices rather than...

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

A

And inventories. Yes, inventories, gas, different things like that. But, yes, we'd like to see it go back up.

Ian P. Cameron
Chief Financial Officer & Senior Vice President, Finance, Methanex Corp.

A

Nelson, we're operating our place, our company really tight right now. We are really trying to manage our working capital really well. So, that's – we're going to keep a lid on that obviously.

Inventories, as John mentioned earlier, a little lower than they've been. And so, there's been some really good work in terms of managing our working capital. So from this environment, we're going to probably stay there. As John said, if we get higher pricing, then it goes the other way which is a good news story.

Nelson Ng
Analyst, RBC Capital Markets

Q

Okay. Got it. And then just on your credit facilities, I know you're sitting on a lot of cash. But I think during the quarter, you repaid $100 million in your revolver, but you drew down $37 million on your construction facility. Can you just give a bit more color as to your strategy with your cash balance and your decision to draw things down? So, I'm just wondering why didn't you make a prepay all of your revolve? Is there some risk that it won't be available in the future? Is that why it's still drawn at, I think about $200 million is drawn right now?

Ian P. Cameron
Chief Financial Officer & Senior Vice President, Finance, Methanex Corp.

A

Yes. So, in terms of -- let me start with the construction loan, a $37 million draw, we're going to draw as we spend money on G3. We're entitled to, it's a fixed term loan. It's not a revolver. It's a non-revolving facility, so we'll continue to do that. And then in terms of cash and liquidity, we're going have a balance in terms of how much cash we want, in terms of having it on the balance sheet versus the negative carry.

And right now, as we've noted in the quarter, we've obtained really we think a good covenant release that allows us to get through the next few – 12 months with lots of flexibility. So, we'll be evaluating over the next little while in terms of how much cash we'll keep on our balance sheet versus returning and repaying the operating facility. We haven't made any decisions yet.

Nelson Ng
Analyst, RBC Capital Markets

Q

Okay. Thanks, Ian. I'll leave it there.

Operator: Thank you. The next question is from Eric Petrie. Your line is open. Please go ahead.

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Good morning, John.

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

A

Good morning.

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Q

With lower methanol prices, have you seen any increased demand for industrial boilers? Or is methanol still less competitive versus either coal or gas?

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

A

Yes. So, the switch to industrial boilers, methanol is really driven by cleaning up the air rather than straight economics. Most of the boilers in China today are coal and they're quite polluting, especially on the [ph] coast (51:53) through the drive to clean up the air. So, three things you can do – use instead of coal are methanol, natural gas and diesel fuel. And natural gas is not readily available throughout China, it's not like an articulated system like we see here in North America.

I think natural gas is a good choice to go to from coal but a lot of areas that you can't get natural gas and I think that's where methanol plays its role. So, I don't think whether methanol is at $200 or $300 a tonne or if $400 a tonne is going to make any impact on the switching rate of coal to methanol in the boiler market. It's more of a technology works and methanol, I can get it delivered. So, it's more of a supply chain issue than actual price of methanol.

We continue to see conversions not only on boilers, but more recently on kilns as well. So, coal-based kilns are starting to convert to those same three fuels. And we see that as a trend that will continue, especially as China looks to clean up its air.

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Q

Okay. So, my follow-up question I wanted to ask in the longer-term dynamics of marine fuel, I think Lloyd's recently approved an ammonia fueled vessel. So, how do you see methanol competing against ammonia and meeting IMO 2030 standards?

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

A

Yes. Well, methanol is a great alternative fuel and will meet the IMO standards going forward. And the thing about it is easy to handle. It's readily available in all parts around the world. It can be stored in regular tanks that are on the ships. So, from a storage and handling and availability, it checks all those boxes. But I've always said, it's not going to be either or. It's going to be a number of solutions that people are going to promote including LNG and ultra-low-sulfur diesel in the short term. And methanol and ammonia has been used in diesel trucks in North America for quite some time.

So, I think it will – it's not going to be a one-size-fits-all solution. And we're pretty pleased with the progress that we're making on methanol as a fuel on board ships. The nice thing I think that methanol has an advantage is it is flexible. So you can have the same engine use ultra-low-sulfur diesel or methanol. So to me that any time you can provide flexibility on fuel of choice, that gives you a leg up on your competition. So, we would continue to see methanol as a fuel on ships growing again significantly probably mid-next decade -- mid- this decade because it's mainly a newbuild story.

Retrofitting, we don't think is going to happen. People will just probably use ultra-low-sulfur diesel, especially in the current environment.

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Q

Okay. How would you size the market opportunity in terms of tonnes?

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

A

Yes. It's about – if every ship was to convert to methanol, which it is not, it is about 500 million tones. So, we don't need very much penetration to have a significant impact on the supply/demand balance for methanol. So a ship like ours, one of our ships just to give you order of magnitude, they're about 50,000 deadweight tonnes. If they run on methanol 100% of the time, it's about 10,000 tonnes to 12,000 tonnes of methanol per year per ship.

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you, John.

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

A

Thank you.

Operator: Thank you. The last question is from Cherilyn Radbourne. Your line is open. Please go ahead.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Thanks very much. Good morning. In terms of the new methanol supply that's scheduled to come online, could you just give some color around what sort of logistical issues you think COVID-19 could have in terms of the timing of those plants coming online?

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

A

Well, it's really around construction. I mean, if you've ever been to a large plant that's being constructed, people are working in pretty close quarters. So, you have to put in quite a bit of safety procedures that you wouldn't normally put in without a virus around, social distancing, masks, cleaning, all the things that are being done everywhere that we see COVID present in a big way. So, that adds time and probably adds people.

And then, you've got the commissioning process. Usually, when you're commissioning a plant, you're bringing people in from all different parts of the world that have expertise in a particular piece of equipment or a particular system or a particular part of the plant. And I think in Trinidad today, that's pretty difficult. In the United States, maybe a bit easier but maybe some people don't want to travel, they're going to do it remotely, and that will add complications.

So, I think not only will construction times be extended, but commissioning could be a lot harder than in a normal environment. But I'm always amazed at what people are able to do when they don't have a choice of being in person. So, people will find ways and – but I think it will be a bit more cost and probably a bit longer, is what I would anticipate. But those plants will get commissioned at some point here in the coming year or two.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Okay. And then last one for me, can you comment on what you're seeing as far as the impact of the sanctions on Iran and the flows of Iranian methanol?

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

A

Yes, really no impact on their ability to produce. I think the impact of sanctions is more on getting spare parts and developing the gas fields to allow them to deliver gas on a reliable level throughout the year. So, we're still continuing to see methanol being shipped and really, the only place it can be sold is China.

Now, India is back open, so there's some going to India and we've seen pricing rebound in India as a result. So, I'd say it's more not the ability to sell the methanol, but it is at a discount to other material but they're still selling it. It's the production and the ability to run their plants reliably going forward.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Thanks for the time, John.

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

A

Thank you.

Operator: Thank you. We don't have any other questions at this time. I'll turn the meeting back to management.

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

Okay. Thank you. So just a couple of clarifying points. I think I mentioned the extension on the G3 completion was 12 months. It's really nine months. So it's now July 2023. I apologize, Joel, for being off by three months. And we have a crack finance team here. So during the call, I didn't realize this, but we have a COVID-19 category for all expenses that are in addition to our normal operating costs related to COVID-19. And so far today, it's $37,000, so just to answer that question. Thanks to the finance team for providing that information.

And I wanted to reiterate that our top priority is keeping our team members safe and healthy. We will continue to operate our plants safely and reliably, deliver secure and reliable supply to our customers, and protect our balance sheet, [ph] do business (59:15) in this uncertain environment and generate significant long-term value as global market conditions recover.

Thank you. Thank you for joining us today. Stay safe and we look forward to connecting with you in October. 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.