FINAL

Bloomberg Transcript

Q2 2022 Earnings Call

Company Participants

- John Floren, President and Chief Executive Officer
- Sarah Herriott, Director-Investor Relations

Other Participants

- Ben Isaacson, Analyst
- Charles Neivert, Analyst
- Hassan Ahmed, Analyst
- Joel Jackson, Analyst
- John Roberts, Analyst
- Josh Spector, Analyst
- Laurence Alexander, Analyst
- Matthew Blair, Analyst
- Nelson Ng, CFA
- Steven Hansen, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Methanex Corporation Q2 2022 earnings call. I would now like to turn the conference call over to Ms. Sarah Herriott. Please go ahead.

Sarah Herriott {BIO 21418601 <GO>}

Good morning, everyone. Welcome to our second quarter 2022 results conference call. Our 2022 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'd like to remind our listeners that our comments and answers today to your questions 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 second quarter 2022 MD&A and to our 2021 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, average realized price, EBITDA, adjusted EBITDA, cash flow, adjusted income, or adjusted earnings per share made in today's remarks reflect our 63.1% economic interest in that Atlas facility, our 50% economic interest in the Egypt facility at our 60% interest in Waterfront Shipping.

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, these items are non-GAAP measures and ratios that do not have any standardized meaning prescribed by GAAP; and therefore, unlikely to be comparable to similar measures presented by other company. We report these non-GAAP measures in this way because we believe they are 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 {BIO 7546684 <GO>}

Good morning. I hope that everyone is continuing to stay safe and healthy. Today we will review our second quarter 2022 financial results, provide an overview of the methanol markets, discuss our operational results and share our near-term outlook. We'll also make a few remarks on the capital cost and schedule, review of our Geismar 3 project and the recent announcement to increase the quarterly dividend. We will then put up the call for questions.

Our average realized price of $422 per ton generated an adjusted EBITDA of $243 million and an adjusted net income of $84 million or $1.16 per share. Adjusted EBITDA was lower in the second quarter compared to the first because of lower sales of Methanex-produced products coupled with higher natural gas and higher logistics costs due to higher bunker fuel prices.

I wanted to remind everyone that we have a gas hedging program in place for our North American assets where we are target hedging 65% of our gas needs to allow us to run our plants at minimal rates if spot natural gas in the United States becomes uneconomical. Next year, we are very well positioned with 85% of our gas needs hedged at significantly lower prices compared to the current spot prices.

After 2023, our hedge position reverts closer to our target of 65%. Global methanol demand in the second quarter was 3% higher compared to the first quarter of 2022. Methanol to olefins or MTO plant operating rates remained high through the quarter, and demand for traditional chemical applications rebounded following the seasonal slowdown in manufacturing activity during the Lunar New Year in China.

Industry operating rates improved in the second quarter with increased production from our end as seasonal gas supply constraints ease with partial offsets with planned turnarounds in Europe and Southeast Asia. As a result, we saw an increase in the availability of methanol in coastal China. This combined with a weaker sentiment from global economic headwinds and the COVID lockdown risks in China has resulted in lower methanol market pricing in China and other major markets globally.

We estimate the industry cost curve based on the marginal coal producer cost in China to be above $350 per ton and expect that a significant amount of production in China is under economic pressure at today's spot pricing levels. We've seen a reduction in Chinese plant operating rates over the last few weeks and affirming of spot pricing in China.

Our August posted prices remain robust but were slightly lower in all regions. North American prices decreased by $10 per ton to $595 per ton. Asia-Pacific and Chinese prices decreased by $30 and $35 per ton to $420 and $375 per ton, respectively. Our European contract price is set quarterly and we decreased our third quarter 2022 price by EUR15 per ton to EUR555 per ton. Decreasing spot prices in the second quarter primarily in China led to a higher discount rate of 23% as we adjusted our discounts in this pricing environment.

Entering the third quarter, our demand outlook remains stable and despite global economic uncertainty. We see demand growth outpacing supply growth in the medium term and a favorable market outlook even if GDP growth rates are lower than expected. High global energy prices enhanced methanol's cost competitiveness against alternative fuels and we continue to see growing demand in energy applications.

Methanol has emerged as a top alternative marine fuel for the shipping industry as they focus on decarbonization and the transition to the low carbon economy. Demand for dual fuel vessels that can run on methanol continues to accelerate. We estimate there'll be over 80 methanol dual fuel vessels on the water in the next few years which represents potential methanol demand of approximately 1.7 million tons per year. We are currently in discussions with over a dozen shipping companies and expect the number of new methanol vessel orders to continue to grow. Our production levels were lower in the second quarter compared to the first quarter due to lower production in New Zealand and Chile.

In Chile, as expected, our production in the second quarter was lower than the first quarter. We typically experienced lower gas deliveries in the southern hemisphere winter months impacting our second and third quarters. We expect to receive higher gas deliveries in the fourth quarter. In New Zealand, The Maui gas field had planned maintenance in May, which extended into June due to weather events and emergent work during the maintenance which restricted gas availability to the plants and resulted in lower production in the second quarter. Based on our revised outlook for natural gas in New Zealand, we are lowering our guidance for the year to 1.3 million metric tons.

We ended the second quarter in strong financial position with approximately $900 million of cash and $600 million of undrawn backup liquidity. Our cash balance was impacted this quarter by the timing of interest and tax payments. Our disciplined approach to capital allocation has not changed. We continue to focus on maintaining our business pursuing economic value-added growth opportunities that exceed our cost of capital by three percentage points, and that can be executed without undue risk while returning excess cash to shareholders.

Construction of our Advantaged G3 project is progressing safely. The team completed (inaudible) in July and we've updated our guidance for the project to begin operations and produce the first methanol in the fourth quarter of 2023 and have lowered the upper band of the capital cost range by $50 million to $1.3 billion. The team has done an excellent job of derisking the project and minimizing the impact of inflationary pressures.

I'm proud that we're able to narrow our capital cost estimate downward in this inflationary environment. We have spent approximately $725 million to the end of the second quarter on G3. We expect approximately $525 million to $575 million of the remaining capital cost before capitalized interest, which is now fully funded with cash on hand. For those of you that were not able to visit the site at our Investor Day in June, I would encourage you to view the project update video on our Investor Relations page to see the latest strong footage of the site.

I'm excited to have G3 online by the fourth quarter of next year as it will significantly enhance our cash flow generation capability and reduce our overall portfolio greenhouse gas emissions intensity. Earlier in July, the Board approved a 20% dividend increase, our third dividend increase in the past 12 months. This increase reinforces our commitment to return cash to shareholders and highlights the strong cash flow generation capability of our assets. Our next reviews of our dividend, our plan around our Annual General Meeting in April 2023 and after the completion of the Geismar 3 project in the fourth quarter of 2023.

We completed our upsized share buyback program in July and a new buyback program will be evaluated in September. With our strong cash flow generation capability, we will continue to returning excess cash to shareholders through a sustainable growing dividend and share buybacks. Based on our lower posted prices through July and August, we expect lower adjusted EBITDA and earnings in the third quarter.

In the medium term, the methanol market outlook is positive. And we have growing cash flow generation with G3 coming online at the end of next year and we will continue to deliver on our capital allocation commitments of returning excess cash to shareholders. We'd now be happy to answer any questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) The first question is from Ben Isaacson from Scotiabank. Please go ahead.

Q - Ben Isaacson {BIO 6619206 <GO>}

Thanks. Thank you very much. Good morning, John. I think you said Q2 demand was up 3% quarter-over-quarter, was that right?

A - John Floren {BIO 7546684 <GO>}

That's correct, Ben.

Q - Ben Isaacson {BIO 6619206 <GO>}

Can you just go into a little bit more color, maybe in terms of the main buckets of methanol demand and how are those playing out to get to that 3% and kind of where do you see those buckets going for the balance of the year?

A - John Floren {BIO 7546684 <GO>}

Predicting the future has never been my strike. So we have not seen any impact in our forecast from our customers for the third quarter and we have those forecasts in place, but that we are all aware of the economic headwinds that are certainly present out there. So I think we're in a time where predicting the future demand is really, really tricky, harder than most times. The main reason for the increase in demand in Q2 over Q1, we continue to see very strong MTO operating rates and we had a bounce back in the traditional chemical derivatives as China came out of its Lunar Holiday. Usually in the first quarter, we see less demand for traditional chemical applications in China.

Q - Ben Isaacson {BIO 6619206 <GO>}

And then just a follow-up question, if I may, I understand in Trinidad that there is a bid round due in January for upstream development with awards likely in April. Is it fair to say that we probably won't hear anything from you on Atlas and/or Titan for about a year because we need to see how those bid rounds develop? Or is that separate?

A - John Floren {BIO 7546684 <GO>}

I think that bid around from what we understand is for deepwater and that's probably longer-term gas than what you should expect in the next 12 months. I think what has to happen in Trinidad we are aware that the upstream contracts are coming due over the next 12 months. They have to be renegotiated as well as most of the downstream contracts are coming due in the same period.

The government has been very clear they want to have everybody survive on the island and to find an economic situation that allows the upstream to do well, that the government to do well and the downstream to do well. So nothing is really changed. I think it's going to take some more time for this to play itself out in Trinidad. But the government has been very clear, they want everybody to continue to operate. So, we're still optimistic that we'll get something for Titan that allows us to stay cash positive through the cycle, but certainly, it will not be at the same economics as our previous deal at Titan.

Q - Ben Isaacson {BIO 6619206 <GO>}

Thanks so much, John.

A - John Floren {BIO 7546684 <GO>}

Thanks, Ben.

Operator

Thank you. The next question is from Joel Jackson from BMO Capital Markets. Please go ahead.

Q - Joel Jackson {BIO 16250849 <GO>}

Hi, good morning, John.

A - John Floren {BIO 7546684 <GO>}

Good morning.

Q - Joel Jackson {BIO 16250849 <GO>}

John, how do you see production -- attributable production play out in Q3 versus Q2? And in terms of $200,000 reduction expectations for volume out of New Zealand this year, it looks about 100,000 that came in Q2. If that's right, and then with 100,000 left to go, would that be more in Q3 than Q4?

A - John Floren {BIO 7546684 <GO>}

Yeah. In New Zealand, we've adjusted our guidance down by 200,000 tons. And that's just based on what we've seen in Q2 with The Maui outage being extended because of weather and some additional repair work that we expect to continue into Q3. So that's why we've adjusted our guidance down to 1.3 million tons. The industry operated, as I mentioned, better in Q2 than Q1 and that's mainly as a result of Iran coming out of their winter season and having more gas availability for methanol and other petrochemicals.

Q - Joel Jackson {BIO 16250849 <GO>}

Great. For yourselves, Methanex, would you see your own production being lower in Q3 than Q2 and then it sounds like your New Zealand impact you're not expecting anything in Q4?

A - John Floren {BIO 7546684 <GO>}

Yeah, we don't guide on our production, Joel. We typically guide that we have two to three turnarounds per year. And we didn't have any in the first half. So -- but we don't give specific guidance on our production numbers.

Q - Joel Jackson {BIO 16250849 <GO>}

Okay. My last question would be the world around us is changing. Gas differentials have gone crazy, as you know, right? The fact Henry Hub is (inaudible) is $40, $50, $60, $70, it's crazy on given days. Does this change your world like short-term thinking on anything? How you view, what you should be doing on gas contracts and hedging? How you should look at your negotiating position with Trinidad government for Titan, is it look at where you want to put your next capital -- your next dollars? How the methanol market may develop depending on gas spreads? Like, what does it mean for you kind of short term and long term thinking?

A - John Floren {BIO 7546684 <GO>}

I think we're in really good shape. We hedged 65% of our needs in North America with us on a fixed price or pure hedges and all those were out of the money for six years and getting criticism we should have bought spot gas in a couple of quarters of what's happened in those hedges are now in the money by quite a lot. So nothing is really changed in our view. Gas supply is our biggest input cost, 50% of our cost structure is gas and we want to have gas firmed either in a fixed way or hedged way or the sharing mechanisms that we have everywhere outside North America for these very reasons that you just pointed out because the future is hard to predict and when gas is at 250 in the United States and Canada, nobody thought it would be at $8 and here we are. So I think we're really well positioned next year with 85% of our gas hedged in North America.

And when I look at our average cost of gas in North America in Q2, it was very similar to the gas price we're paying in other parts in the world with a sharing mechanism. So I think we've done a really good job in insulating us from this current energy crisis that we're seeing.

Q - Joel Jackson {BIO 16250849 <GO>}

Okay. Thanks, John.

Operator

Thank you. The next question is from Steven Hansen from Raymond James. Please go ahead.

Q - Steven Hansen {BIO 15756282 <GO>}

Yeah, good morning guys. John, just the first one for me is just around sales mix and sales allocation to different regions. Has there been any meaningful shift in where you steering your tons in the last sort of six months or so? I'm just noting that the global weighted average contract seems to be shifting a little bit towards some of the lower-priced regions at least that's how the math would suggest?

A - John Floren {BIO 7546684 <GO>}

Not really, Steve. We set our supply chain on an annual basis, so we don't change our customer base all that regularly. So the amount of product, I'd say over the last year, is a bit more going to China than previously. But it really doesn't change within a calendar year. We're in the process now of looking at what we're going to do for next year and our marketing team are looking to sell more in Europe as the Russian material at 1.5 million tons of imports into Europe from Russia. Most customers are indicating they don't really want to deal with Russian product in the current environment and are asking suppliers like us to sell more.

So I think as we go through the contracting period in the second half of this year, we're going to try and sell more in Europe and then less in Asia, but in any given year about maybe a quarter of our contracts come up, so we don't have the ability to change things quickly (inaudible) as much product as we can keep in the Atlantic Basin that would be our preference, especially in the current freight environment where fuel pricing are so high. It's very -- it's like a $50 advantage to keep the product in -- just on freight alone to keep the product in Atlantic, never mind the netbacks are better as well.

Q - Steven Hansen {BIO 15756282 <GO>}

Of course, that makes sense. And just one follow-up is just around contract structure specifically in Europe when reading that there has been some customers now finally willing to enter into monthly contracts which is provide just a bit better, I guess more timely update to the market. Have you guys contemplated moving down that road here at some point in the future we've been dealing with Europe quarterly contracts for as long as I can remember?

A - John Floren {BIO 7546684 <GO>}

Yes, we'd love to move to monthly in Europe. I think with all the volatility that is going on in the world, quarter seems like forever when you're setting a price. So sometimes you win, sometimes you lose, but I think monthly has been our preference for a long time. We just haven't been able to be successful. So customers want to move to monthly with us, we'd be very welcome of that kind of change.

Q - Steven Hansen {BIO 15756282 <GO>}

Okay, great. Appreciate the color.

Operator

The next question is from Nelson Ng from RBC. Please go ahead.

Q - Nelson Ng {BIO 16615616 <GO>}

Great, thanks, and good morning. So my first question relates to G3. You are now guiding to first methanol production in Q4 of next year. Can you just talk about how long it generally takes for the facility to reach full commissioning after first production. Are we looking at a few months or longer?

A - John Floren {BIO 7546684 <GO>}

Well, the last two plants we commissioned were G1 and G2 and they took weeks. So, our team is really, really good at commissioning plants and that starts when you design a plant, it doesn't start when you got to turn the plant on and how you build it, how you design it, the expertise we have in place to do the commissioning.

We're fortunate that gentleman that did the commissioning for G2 is going to be commissioning for G3 and he did an outstanding job on commissioning for G2 and we have a really talented and experienced team in place and we'd be very disappointed if it took months to commission that plant. When you commission a plant, you line it out and you may take it down for a few days to fix some things that may not have been apparent but I'm expecting the commissioning on that plant to go really well.

Q - Nelson Ng {BIO 16615616 <GO>}

Okay. So we should probably expect first methanol production and full commissioning sometime in Q4?

A - John Floren {BIO 7546684 <GO>}

We'll start the plant up and anticipate that it will take a number of weeks to commission the plant and that product starting to flow through our actual sales in the first part of 2024.

Q - Nelson Ng {BIO 16615616 <GO>}

Okay, got it. And then just moving over to logistics costs like obviously, that was one headwind in Q2, are you seeing logistics costs moderate in Q3, or is there a bit of a lag in terms of the high oil prices and bunker fuel and how it flows into your costs?

A - John Floren {BIO 7546684 <GO>}

Yeah. So I'll remind you, our logistics cost with the exception of fuel are set annually with Waterfront Shipping for Methanex. So, those are in place for 2022 and that'll be renegotiated with Waterfront at the end of the year. So we're fixed on our shipping costs where we've seen higher costs is really to do with the fuel that we're burning.

So all of the ships that can burn methanol are running 100% on methanol because the economics are much better than ultra-low-sulfur diesel or marine gas oil, so that's a real advantage for us with almost half of our fleet running on methanol. When I look at the shipping market itself, the clean petroleum products, the liquid carriers, no, they never really benefited from all of the other containers in the dry bulk rates that went up over the last few years and with what's happened with the war in Ukraine, Russia is looking to move its products to farther markets like Asia, India, China, which has really tightened up that liquid shipping market quite significantly, which means the rates that you would be paying on a spot basis have gone up quite substantially.

We're not impacted by that because we've got the rates negotiated with Waterfront, so not only do we have a benefit of running methanol at our ships, but we have the benefit of having these fixed prices on our shipping for the year. So we're in a really good position right now to take advantage of even all the backhaul that we do, we're getting a much higher rate for the one-third of the part that we carry on our ships that is not methanol clean petroleum products, so that we get that additional revenue in a market like this. So we're really well positioned on our shipping side.

Q - Nelson Ng {BIO 16615616 <GO>}

Okay. So just to clarify the higher logistics costs, see in Q2 versus Q1, that was mainly due to higher methanol costs that in terms of fuel costs?

A - John Floren {BIO 7546684 <GO>}

Higher fuel cost in this time last year. Right? So if you look quarter or year-over-year and every quarter where we send product based on outages based on where we think to optimize our global supply chain in an environment where you're paying higher for fuel, it gets exasperated a little bit and that's what we saw in the quarter.

Q - Nelson Ng {BIO 16615616 <GO>}

Okay and then just finally on the hedges. You mentioned that you're 85% hedged next year and 65% thereafter. How are you hedged for the rest of this year? Or when you say next year, is it for the next 12 months starting in Q3?

A - John Floren {BIO 7546684 <GO>}

For 2023, we're 85% hedged. For 2022, we're 65% hedged or fixed price.

Q - Nelson Ng {BIO 16615616 <GO>}

Okay, got it. So should we think, like so from that perspective, should we think of it in terms of taking 35% of the North American production and plugging in the spot price for gas to look at the change in gas costs from a production perspective?

A - John Floren {BIO 7546684 <GO>}

If we choose to run at full rates, yes. But we have the ability to go down to 65% if it makes more sense to buy product in China than to make it in North America and ship it to China, then we will make that decision. So if we do run at higher than minimum rates, spot gas would be a good proxy for the gas price for the 35% to start hedge, but that's assuming we're going to not go to minimum rates.

Q - Nelson Ng {BIO 16615616 <GO>}

Okay, that makes sense. Thanks. I'll leave it there.

Operator

Thank you. (Operator Instructions) The next question is from Matthew Blair from TPH. Please go ahead.

Q - Matthew Blair {BIO 16648009 <GO>}

Hey (Technical Difficulty) for taking my question. Circling back to the 3% quarter-over-quarter demand improvement, which seems like a pretty good number, do you have a sense of how much China lockdowns might have played a role in Q2 and I guess where I'm getting here is, was that 3% actually muted due to China lockdowns?

A - John Floren {BIO 7546684 <GO>}

Yeah, our view is if China didn't have the COVID lockdowns, demand would have grown more than 3%. The impact is really on fuels for driving like M100, MTBE. When you are locked down, you're not getting into your car and traveling, and so our view was if we didn't have the COVID lockdowns during the quarter, we probably would have seen additional demand growth in China.

Q - Matthew Blair {BIO 16648009 <GO>}

Great. I'll leave it there. Thank you.

A - John Floren {BIO 7546684 <GO>}

Thank you.

Operator

Thank you. The next question is from Josh Spector from UBS. Please go ahead.

Q - Josh Spector {BIO 20933212 <GO>}

Yeah, hi, thanks for taking my question. I guess when we looked at your realized pricing in the quarter, if you're just to be about 25% weighted average discount to your post the contract price, maybe that's more normally around 20%, pricing was sequentially similar, so what was the driver of that? Is that more a mix of where you're selling, or is there anything else to consider? And what would you think about that discount into next quarter?

A - John Floren {BIO 7546684 <GO>}

Yeah, well, Q2 discount was 23% and we guide to 20% and that was mainly caused by spot pricing in China falling quite rapidly faster than the contract price, which meant we adjusted our discounts to stay competitive in that market. Hard to predict what's going to happen in Q2. We've seen China spot prices rebound quite nicely here, even overnight another significant increase. So it will be a factor what the Chinese spot price does which will impact our discounts. So again, difficult to predict in this environment, but certainly spot markets in China and other regions in the last week to two weeks have bounced back nicely.

Q - Josh Spector {BIO 20933212 <GO>}

Okay, thanks, that's helpful and just curious, is there any point where European gas economics matter at global methanol pricing? Or is that just so far at the end of the curve and there's so much other excess capacities, it never really becomes a meaningful driver?

A - John Floren {BIO 7546684 <GO>}

Well, it matters today because you have methanol production shut down in Europe that's uneconomical. You've got in Norway the ability of the producer there to make methanol and so methanol or take the gas and sell it into the European market, and you've got a big demand for LNG in Europe as well. So in today's environment, it makes a lot more sense to be taking gas and making LNG than making methanol and sell it for $400 a ton.

So yeah, higher energy environment is overall very good for our business, very good for demand. But I think trying to build a new plant or getting a new plant started or it would be really difficult in this environment because you're probably unlikely to get economic gas that would allow you to make a 25-year investment.

So, yes, it's really interesting what's going on, how long it lasts is anybody's question, and like I said, we're really well positioned for the next 18 months and longer that we've locked in our cost position. So I wouldn't want to be naked on the gas markets today and trying to make methanol and sell it at 400 bucks a ton. It wouldn't be very economical. So we're well positioned and we'll see how things unfold.

Q - Josh Spector {BIO 20933212 <GO>}

Yeah. Thank you.

Operator

Thank you. The next question is from Laurence Alexander from Jefferies. Please go ahead.

Q - Laurence Alexander {BIO 21637617 <GO>}

Hello. Just two quick ones. Can you give some perspective on how the volatility in the gas markets is affecting how the marine customers are thinking about incentivizing new plant construction given how large the marine demand could be in the medium term? And secondly, how is the volatility in feedstock prices affected the Chinese discussion and strategy around industrial boiler conversion to methanol?

A - John Floren {BIO 7546684 <GO>}

Yeah. So I'm not aware of any marine customer today asking to have a share in a methanol operation to underpin their plans to buy these flex fuel ships and I think that's the reason is there are flex fuel, so they're not going to be stuck in the one fuel. They'll be able to switch back and forth from methanol marine gas (inaudible) diesel provided the environmental regulations are such that allows them to run diesel or MGO.

I'm aware of (inaudible) signing a bunch of LOUs or letters of intent with a number of green methanol projects. To my knowledge, none of them are under construction, none of them made FID, none of them have come to commercial arrangements with the type of pricing that's needed to underpin those investments. So not aware of anything, Laurence, at this time. And the second question was, sorry, just repeat it for me.

Q - Laurence Alexander {BIO 21637617 <GO>}

Sorry, on the Chinese industrial boiler strategy?

A - John Floren {BIO 7546684 <GO>}

Yeah, we're continuing to see developments there and yeah, high coal price in China, 1200 RMB per ton, certainly makes the economics of methanol even more attractive versus natural gas or diesel.

And it's always been driven by environmental concerns on the coast, so those environmental concerns are still there and now the economics for methanol are much more attractive than diesel or natural gas. So we would continue to see positive uptake in that demand not only for boilers but for kilns, which is the newest application for methanol to replace coal in kilns. I don't know if you saw those little ceramic mascots during the Olympics, but they were made from a kiln that ran on methanol.

Q - Laurence Alexander {BIO 21637617 <GO>}

Interesting. Thank you very much.

A - John Floren {BIO 7546684 <GO>}

Thank you.

Operator

Thank you. The next question is from Hassan Ahmed from Alembic Global. Please go ahead.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Good morning, John.

A - John Floren {BIO 7546684 <GO>}

Good morning.

Q - Hassan Ahmed {BIO 7430123 <GO>}

John, wanted to revisit the demand growths. Couple of questions around the sustainability of this 3% sequential uptick you guys saw in methanol demand in Q2. If I'm hearing it correctly, your commentary sounds quite positive and bullish despite all the sort of headwinds and tailwinds. Just want to sort of think through it. Obviously, a high crude oil/energy price environment is positive for methanol demand growth. The ethylene, polyethylene side of things seems a bit negative because pricing hasn't been great. But then again you obviously have the whole sort of China lockdown easing side of things as well. So now with all these factors considered, is it fair to assume that, at least in the near term, this sort of 3%-ish sequential uptick in demand that we saw is sustainable? And also where does inventory factor in in thinking through the whole sort of demand growth side of things in the near term?

A - John Floren {BIO 7546684 <GO>}

Well, if I'm sounding bullish on demand, I need to change by tone because it's very (Multiple Speakers). There are tailwinds but and headwinds and when we balance them out, we see based on our forecast we got from our customers today, continue to be very good demand. I'll remind you, there is a new MTO plant being commissioned in the quarter, which will add 1.8 million tons annualized at full operating rates that wasn't there in previous quarter.

So that will have a nice bump. A high-energy environment like I mentioned all of our ships are running on methanol and I'm sure other ships that can are as well. MTBE demand continues to be quite good in markets where there is no lockdowns and we expect that to rebound in China as well, but we all read the same headlines about recession (inaudible) a recession, you could see the traditional chemical derivatives not grow as quickly, but you'd have to see a real drop in demand. The last few times we saw methanol pricing get below 300 it's when we had double-digit kind of demand shocks around the oil crisis in '16, the financial crisis and COVID. So we are certainly not expecting a double-digit demand drop in methanol, but again I can't predict the future. And based on our current outlook from our customers and from what we're seeing in the marketplace, we still expect demand to be quite solid.

Remind you as well, there are two idle MTO plants in China that have the ability to restart and the whole dynamic on the ethylene and propylene chain and the relative price of naphtha we understand that some of the North Asian crackers have reduced rates because of the economics in their chain as well.

So I think at current methanol prices, MTO continues to be okay and running at high rates, but that's something we watch very closely, the affordability of methanol in MTO versus naphtha into crackers. So, yeah, all these dynamics are really complicated and they add up to what we think is a pretty good demand profile, everything else being equal going forward in Q3.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Understood, very helpful. And as a follow-up around Europe, it's not obviously an insignificant amount of methanol capacity, call it 10% of global capacity sitting in Europe, the commentary coming out of places, particularly like Germany sounds pretty dire, right, with some of the producers out there and I'm not talking methanol producers but call it producers that of polyurethanes in the like that you use methanol as a raw material, talking about shutdowns in the like. So the question really is that, are you having some initial conversations with some of these downstream sort of producers of products like polyurethanes and the like that are maybe potentially considering outsourcing the methanol side of their operations to you guys?

A - John Floren {BIO 7546684 <GO>}

Yeah. Not aware of any discussions like that, but I would agree with your assessment on the dynamics there and there's a couple of refineries in Germany that make some hundreds of thousands of tons of methanol as part of their complex as well. So how does that continue in the current energy environment in Europe is a big question mark.

And how does that even our customers or customers of our customers survive paying $40 in MMBtu for gas, so there may be some shifts where derivatives get made over the coming years. But certainly, hard to predict. And the nice thing about being a global supplier with a globally integrated supply chain, we can move very quickly to go where the demand ends up being if it's not in Europe.

So I think we're again very well positioned to make sure that we continue to be a good supplier to our customers wherever that demand may end up.

Q - Nelson Ng {BIO 16615616 <GO>}

Very helpful, John. Thank you so much.

A - John Floren {BIO 7546684 <GO>}

Thank you.

Operator

Thank you. The next question is from Charles Neivert from Piper Sandler. Please go ahead.

Q - Charles Neivert {BIO 1825934 <GO>}

Good morning, guys. Just a quick thing. One, would you -- I guess you answered this earlier, but just want to make sure you can or might conceivably adjust production in different areas where the gas prices highlight if you have $9 gas on unhedged stuff in the US, you might adjust production to another site assuming it can be done or would purchase if it's cheaper to do it that way, that's something you've already done or would plan to do again?

A - John Floren {BIO 7546684 <GO>}

Yeah, outside North America, we have the sharing mechanism in our gas contracts, so our gas prices are set and we're cash positive through the cycle and in this environment 100-plus per ton of EBITDA. So I don't see us adjusting operating rates outside North America based on high-priced gas because our contracts are set with a floor plus a sharing mechanism.

Inside North America, about 65% of our requirements are hedged this year, 85% next year. So take this year if the pricing of gas gets to a situation where it's more economical to buy product in China and reduce operating rates in North America, mainly Geismar, and yeah, we would do that. And I'm not about to say today what we've been doing, what we plan to do, but directionally that makes more sense to buy versus make, that's what we'll do.

Q - Charles Neivert {BIO 1825934 <GO>}

Okay. And then as a follow-up, how much more Iranian capacity is available? Should it have been able to have gas? I looked at the numbers of the different operations that are running. Are there any more yet to start up or that might conceivably start up during the course of the quarter? Or (Multiple Speakers) ramping?

A - John Floren {BIO 7546684 <GO>}

No, not in the short term, Charlie. We understand there is 100 construction we believe sometime maybe next year or hard -- it's pretty opaque, but nothing imminent. What we saw in the quarter was the plants that are able to operate today increased operating rates because of more available gas as they came out of their wintertime, but this phenomenon has been going on for quite some time in Iran until money was invested in the upstream to build out the infrastructure.

We would continue to see restrictions on gas to the uranium production. The same pattern we've seen in the previous year as in the summer, they get a little bit more gas to make a little bit more methanol and until they make those investments, probably that's what's going to be occurring going forward.

Q - Charles Neivert {BIO 1825934 <GO>}

Okay, thanks very much.

A - John Floren {BIO 7546684 <GO>}

Thank you.

Operator

Thank you. (Operator Instructions) The next question is from John (inaudible) from Credit Suisse. Please go ahead.

Q - John Roberts {BIO 16480058 <GO>}

It's John Roberts, but hi, John.

A - John Floren {BIO 7546684 <GO>}

Hi, John.

Q - John Roberts {BIO 16480058 <GO>}

The progress on the methanol ships is impressive, but there's also industry discussion about ammonia ships as well. Do you know if those ammonia ships are being planned as dual methanol and ammonia? Or maybe try fuel flexibility with diesel as well or will the ship operators have to choose between methanol or ammonia and not both?

A - John Floren {BIO 7546684 <GO>}

Yeah, I'm not aware of any dual fuel vessels with methanol and ammonia. I'm aware of ammonia being discussed as fuel for ships. I think they're behind where we are. I'm aware of engine manufacturers looking at producing engines that will run on ammonia. It's a bit challenges with ammonia around the handling and the storage, quite different than methanol, a lot more has to be colder and it's a bit more hard to handle, not to mention ammonia leaks or releases are not good for anybody.

So I think that from a safety perspective, I think methanol certainly has advantages. So yeah, I've never said it is going to be 100% methanol. I think back in the day when we were proving out this technology, the big noises around LNG and the whole industry is going to go to LNG, and we know that didn't happen for obvious reasons, handling in price and now ammonia I think will take up some of the space and again methanol doesn't need to have very much of penetration to have a significant impact on methanol demand.

So I would expect some ammonia ships to be built and that to be a viable product going forward, provided they can get the engines, may get the handling issues resolved and then bunkering of ammonia and availability of ammonia at all the terminals in the world. So all doable, but I think it will take some time.

Q - John Roberts {BIO 16480058 <GO>}

And then back on to the question if there is actually methanol rationing that occurs with some of the capacity being down. What are the highest values in use of methanol? Are the chemical applications almost always the highest value use of methanol and not fuel given how high oil prices are and fuel prices are?

A - John Floren {BIO 7546684 <GO>}

Well, the one that's always on the margin today is MTO and that's really depending on what happens in the olefins markets and that's really a factor of naphtha pricing and how much that feedstock costs for all the crackers around the world that aren't using methanol or ethane as a feedstock. And that's a lot of capacity, so it's MTO is the one that we watch that's on the margin and I don't expect that to change unless you have a view that olefin prices are going to go up 50% from where they are and that's certainly not our view.

Q - John Roberts {BIO 16480058 <GO>}

Great. Thank you.

A - John Floren {BIO 7546684 <GO>}

Thanks, John.

Operator

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

A - John Floren {BIO 7546684 <GO>}

Okay, thank you for your questions and interest in our company. Before we close the call, I want to emphasize we produce an essential chemical building block, which is used in hundreds of consumer and industrial products. Methanol is also a cleaner burning fuel that has increasing demand as a marine fuel. We believe that the methanol industry has a positive outlook with growing demand and minimal new capacity additions.

Our well-positioned asset portfolio generates meaningful cash flow across a range of methanol prices which allows us to execute on our capital allocation priorities. Excitement is growing across the organization for the start-up of Geismar 3 in the fourth quarter of 2023. This plant will deliver significant shareholder value and further enhance our asset portfolio. There's a lot to look forward to. And we hope that you will join us in October when we update you on our third quarter results. Thank you.

Operator

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