Q4 2022 Earnings Call

Company Participants

- Rich Sumner, President and Chief Executive Officer
- Sarah Herriott, Director of Investor Relations

Other Participants

- Ben Isaacson, Analyst
- Bernard Horn, Analyst
- Jacob Bout, Analyst
- James Cannon, Analyst
- Joel Jackson, Analyst
- Laurence Alexander, Analyst
- Steve Hansen, Analyst

Presentation

Operator

Good morning, my name is Regina and I will be your conference operator today. At this time, I would like to welcome everyone to the Methanex Corporation 2022 Fourth Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator instructions).

I would now like to turn the conference over to the Director of Investor Relations at Methanex, Ms. Sarah Herriott. Please go ahead.

Sarah Herriott {BIO 21418601 <GO>}

Thank you. Good morning, everyone. Welcome to our fourth quarter 2022 results conference call. Our 2022 fourth quarter news release, management's discussion and analysis and financial statements can be accessed from the reports tab of the Investor Relations page on our website at methanex.com.

I would like to remind our listeners that our comments and answers to your questions today may contain forward-looking information. This information, by its nature, is subject to risks and uncertainties that may cause the stated outcome to differ materially from the actual outcome.

Certain material factors or assumptions were applied in drawing the conclusions or making the forecast or projections, which are included in the forward-looking information. Please refer to our fourth quarter of 2022 MD&A and 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 reflects our 63.1% economic interest in the Atlas facility, our 50% economic interest in the Egypt facility, and 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 companies.

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 matter.

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

Rich Sumner {BIO 22500227 <GO>}

Thank you, Sarah and welcome to all of you. We appreciate you joining us today as we discuss our fourth quarter and full-year 2022 results. I'm excited to be leading the Company and to be having my first earnings call since becoming CEO of Methanex on January 1. In December, we announced changes to the executive leadership team or ELT with a few longstanding ELT members retiring. I want to thank them for their significant contributions to the Company. The new members of the ELT, all have extensive industry experience and as a team, we all share a passion for safety and value creation.

Let's turn to a review of our fourth quarter and full-year 2022 financial results. For the fourth quarter, our average realized price of $373 per tonne, generated adjusted EBITDA of $160 million and adjusted net income of $0.73 per share. Adjusted EBITDA was lower in the fourth quarter, primarily due to lower proceeds from the redirection and sale of natural gas in Egypt, partially offset by the benefit of a decline in gas and logistics costs.

In 2022, we recorded annual adjusted EBITDA of $932 million and robust adjusted net income of $343 million or $4.79 per share. Combined 2021 and 2022 are the highest adjusted EBITDA and operating cash flows in the Company's history. I'm proud of the team for delivering another year of strong financial results and I'm very excited for the

Geismar 3 plant coming online this year, as it will further enhance our cash generation capability. We estimate that global methanol demand increased slightly in 2022 to 88 million tonnes. Methanol demand in the fourth quarter was down approximately 5% compared to the third quarter of 2022, primarily driven by lower MTO operating rates.

MTO affordability was under pressure from low olefins prices leading to lower operating rates and some plant outages. Demand from traditional chemical applications was also slightly lower due to lower consumer spending, year-end destocking in Europe and Asia and continued lackluster demand in China due to COVID-19 restrictions. Demand from energy-related applications was relatively stable in the fourth quarter.

Industry operating rates in the fourth quarter were similar to the third quarter with lower operating rates in China and Iran due to the seasonal diversion of natural gas to meet power demand offset by stronger operating rates from the Atlantic region. High coal pricing in China continues to provide support to the methanol cost curve.

We estimate the industry cost curve based on the marginal coal producer costs in China to be approximately $330-$350 per ton, with coal pricing continuing to remain well above RMB1,000 per ton levels. Based on these industry supply and demand fundamentals, we are seeing relatively balanced markets in the Atlantic and tight markets across Asia and China, underpinned by high energy pricing globally.

Our February posted prices remained stable in North America and increased in Asia and China. Less volatile spot prices in the fourth quarter, primarily in China led to a lower discount rate of 20.5% compared to 21.5% in the third quarter. In 2022, we had an average discount rate of 21% and in 2023, we had a similar discount rate. We continue to monitor the macroeconomic and energy price environment, we see potential demand upside from the reopening in China, following the Lunar New Year given the significant methanol demand in China, as well as in Asian countries with strong economic ties to China. We continue to see a high global energy price environment, which enhances methanol's cost competitiveness against alternative fuels, supporting demand growth.

Interest from the green industry and orders for dual fuel vessels able to run on methanol continue to grow. Based on existing dual fuel ships and orders to date, demand potential growth from approximately 300,000 tons today to 3 million tons over the next few years. On the supply side, we do not anticipate any capacity additions outside of China in 2023, besides our Geismar 3 project, which is expected to start production in the fourth quarter.

Turning to operations, our production levels were higher in the fourth quarter compared to the third quarter and the Egypt plant restarted after an extended turnaround. We had higher gas availability in Chile and New Zealand and no plan turnarounds. We did experience unplanned outages in Geismar, Chile and Trinidad that impacted the fourth quarter production.

In 2023, we have three planned turnarounds, which will be undertaken sequentially and complete by September. Our forecasted production for 2023 is approximately 6.5 million equity tonnes, excluding production from G3. Although actual production may vary by quarter based on timing of these turnarounds, gas availability, unplanned outages and unanticipated events.

We ended the fourth quarter in a strong financial position with approximately $806 million of cash, excluding non-controlling interests and including our share of cash in the Atlas joint venture and with $600 million of undrawn backup liquidity. Construction on our Advantage G3 project is progressing safely on time and on budget with production expected in the fourth quarter of this year.

The expected G3 capital spend remains unchanged at $1.25 billion to $1.3 billion and we spent approximately $910 million before capitalized interest to the end of the fourth quarter. The remaining $415 million to $465 million of capital expenditures and including approximately $75 million in accounts payable is fully funded with cash on hand. We are looking forward to adding G3 to our asset portfolio as it will enhance our cash flow generation capability and lowered the CO2 intensity of our portfolio.

Looking ahead to the first quarter of 2023, we continue to see a strong methanol pricing environment and we expect slightly higher production in the first quarter compared[ph] to the fourth quarter. I'd also mention that our sales are produced product were meaningfully lower than our production for the fourth quarter. As a result, we're expecting much higher sales of produced product and higher adjusted EBITDA in the first quarter of 2023 compared with the fourth quarter of 2022.

In the medium term, the methanol market outlook is positive and we have growing cash flow generation capability with G3 production expected in the fourth quarter of this year. At $375 per metric ton methanol price and $4 MMBtu gas, we expect G3 to generate approximately $250 million of EBITDA per year. With our G3 projects being fully funded with cash on hand and our ability to generate meaningful cash flows across a wide range of methanol prices, we are well positioned during this period of economic uncertainty to maintain a strong balance sheet, pursue economic value-added growth opportunities and continue returning excess cash to shareholders. We would be now be happy to answer questions.

Questions And Answers

Operator

(Operator instructions). Our first question comes from the line of Joel Jackson with BMO Capital Markets. Please go ahead.

Q - Joel Jackson {BIO 16250849 <GO>}

Hi, good morning, Rich. Congrats on your first quarter as CEO.

A - Rich Sumner {BIO 22500227 <GO>}

Thanks, Joe.

Q - Joel Jackson {BIO 16250849 <GO>}

If I look at what's going on in the market. Pricing is about similar in Q1 as Q4, gas prices are lower, you have a lot more sales. Would you not say that Q1 earnings should be significantly higher than Q4? Is there anything you can do to kind of quantify a bit more?

A - Rich Sumner {BIO 22500227 <GO>}

I think you probably can put it together, I think the much higher on produced sales do that, if you kind of look at production and then think about our inventory balance, you can probably project what that means in terms of produce sales. And you're right Joel, in this environment where margins are strong and so we're expecting much higher earnings along with that

Q - Joel Jackson {BIO 16250849 <GO>}

And then New Zealand production is starting to come back, but it seems like a slide here, and maybe some of the Chile production in '23 looks a bit, like not growth there. I'm wondering if there is one of the turnaround is happening in Chile this year, and then more generally like I know we're in '23, but can you maybe talk about how to get into '24? How might Chile and New Zealand volumes look better, like what's on the table, considering all the things going on those countries and Argentina?

A - Rich Sumner {BIO 22500227 <GO>}

Sure. Yeah all -- maybe I'll start with New Zealand. So in New Zealand, as you know we've got gas contracts that go out to the end of the decade. We're a big gas consumer there, so we work closely with our gas suppliers, on their drilling campaigns to support our contracts and our 2023 forecast is based on what we see relatively tight market in 2023. We continue to be optimistic with their drilling campaigns, as well as their well maintenance activities that are going to happen this year on the outlook for more an incremental gas to the two plants for at Motunui. Long-term or medium to longer term, we think it's favorable dynamics in New Zealand. The Taranaki Basin is a well-developed basin that reserves are there, its economic gas and in the high energy price, there is associated gas that comes with that. We also think we're a big consumer in the region and the other consumption isn't power and increasingly, I think New Zealand's recognizing the importance of gas for power generation. So we're cautiously optimistic there that and we're going to continue to work really closely with the gas suppliers. So that's kind of New Zealand.

When we talk about Chile, we've got gas coming -- into Chile coming from suppliers in Chile. But that gas happening all year round, and then we have gas coming from Argentina which happens outside of the winter months there. We are forecasting similar gas supply as 2022 and 2023. We continue to work with in particular with suppliers in both Chile and Argentina.

Argentina, there's a quite positive things happening within Argentina and we think can be significantly change the balance there. One is that, there is a lot of development happening in the Neuquen Basin and the Vaca Muerta and there's pipeline connections being made which likely will supply domestic markets there and reduced need for imports of LNG. And it also depends on gas in the south, where our plants are and there's investments happening in the South. There is an investment by Total and Wintershall $700 million project, where they're developing gas. It's meant to come online in the next year and a half or so. So we're continuing discussions there and remain again optimistic future gas, but things have to happen in Argentina for that to come unfold.

Q - Joel Jackson {BIO 16250849 <GO>}

And just finally, if I could be greedy here. Can you tell me G3 did commissioning start in January, as part of that question. How many months did it take from first commissioning to first production at both G1 and G2 and would a similar timeline makes sense for G3?

A - Rich Sumner {BIO 22500227 <GO>}

Well, I guess it depends on your definition of commissioning. When we're commissioning a plant, we -- what we're doing is, as the different systems and the plant are complete. We're handing it over to the commissioning team. So as of right now, the power supply system is being commissioned and handover to the team, that will continue to handover different parts of the plant as they become available. So that -- all that is built into our timelines when we say production in the fourth quarter and that we think once, we actually get tempting to start up the plant, it's a matter of weeks not months, because of all that pre-work done by the commissioning team.

Q - Joel Jackson {BIO 16250849 <GO>}

Okay. Thank you.

Operator

Your next question comes from the line of Ben Isaacson with Scotiabank. Please go ahead.

Q - Ben Isaacson {BIO 6619206 <GO>}

Thank you very much and good morning everyone. Rich, I'm just want trying to figure out 2023 in terms of demand. There is a big story about China is starting to reopen this year and the US and the EU perhaps going into recession. And you mentioned that we had about 88 million tons of demand in '22. Can you talk about where incremental demand comes from and '23 is going higher, is it going lower? And what about incremental production? So you said that outside of China, G3 is the only asset coming online, but what's happening in China, how much new production or change in production do you expect to see?

A - Rich Sumner {BIO 22500227 <GO>}

Sure. So the demand -- thanks Ben, demand question is kind of maybe a large one. I'll try to tackle that one first. So we break down demand, we break it into both, I guess, segments as well as regions. Traditional chemical applications at 50% of demand. The MTO is 15% to %20 and then other energy applications is 30% to 35%. A significant portion of that demand overall is in China, 60% of overall demand is in China, and another 10% to 15% is in other Asian countries. So with a strong linkage to China.

So when we look at it -- we're looking at it both regionally and also by derivative, where demand we see growing, all applications in China and Asia could be help and supported with the reopening of China. We're looking at forecast day that are predicting 4% to 5% or above growth rates in China on reopening.

We're going to have to wait and see. We didn't see that demand ahead of the Chinese Lunar New Year and we're -- but we are seeing a lot of activity in that country coming out. So we're going to be cautiously optimistic there on really all applications.

For MTO when we -- what we saw towards the end of last year is 15% decline in MTO demand. It was really on the back of two large scale plants. One of which has already restarted and we know one plant is down that consumes over 2 million tonnes. We think the reason for that continuing to be down as they actually had refinery expansion and they're commissioning naphtha cracker ahead of the derivative downstream being commissioned and we believe that MTO, they have plans to restart MTO, once it's all commission. So we think that actually is likely to happen and we also think new Iranian supply after winter would be a logical place for a lot of that to supply into. So we look at the olefins market and say, yes, it's been under pressure. But we think MTO has been competitive to naphtha and there is a likelihood we see more. We have to wait and see.

So hopefully that answers some of the questions on demand and we can revisit that. Maybe I'll switch over to China capacity and when we look forward, we're seeing maybe about 1.5 million tons to 2 million tons of new capacity in China this year. We also will net that off of -- most of that's coming from cooking gas. When that off and also the fact that there is a continued shutdown of smaller inefficient plants in China, so call it 1.5 million tons, which is not that meaningful, when you look at overall demand and overall demand growth. So maybe I'll stop there and see if you have any follow-up questions.

Q - Ben Isaacson {BIO 6619206 <GO>}

Yeah. No, that's perfect. And then just a quick one on the cost curve. I was very surprised that through China's lockdown last year, we didn't really see that thermal coal price drop a lot them and so the methanol -- the marginal cost of methanol held in really well. And now in 2023, we're going to see China is starting to reopen. What is the downside to that core price if any? I mean, it seems like the cost curve has a lot of support either where it is or potentially higher. Do you know -- do you have an idea what could be derail of the cost curve in '23?

A - Rich Sumner {BIO 22500227 <GO>}

It's hard to see in a high energy price environment. China is importing a lot of energy, LNG and oil and coal production, yhey had a real difficult time increasing coal supply through the last year. We understand that that's partially on the back of labor and COVID restrictions, getting people to mind. So the -- some of that could free up, but we also understand a lot of these mines are quite. I've already been mine quite deep and going any further causes safety concerns and other factors. And it's not easy to invest in a large scale mine, it takes time to bring production on.

So we kind of forecasts -- and I think there's likely type coal markets. It does seem like China might be trying to open up more imports, talk about lifting the ban on Australian coal imports, but imports into China represents between 5% and 10% of overall thermal coal demand. So it's hard to see that being a major swing in the coal pricing. Hopefully that helps.

Q - Ben Isaacson {BIO 6619206 <GO>}

That's great, thanks so much.

Operator

Your next question comes from the line of Steve Hansen with Raymond James. Please go ahead.

Q - Steve Hansen {BIO 15756282 <GO>}

Yeah, good morning guys. Appreciate the time. Just a quick clarification question on the discount rate. Rich, I think you referenced the '23 rate as being similar to what we saw in the fourth quarter. I just wanted to clarify some of your opening remarks.

A - Rich Sumner {BIO 22500227 <GO>}

Yeah, that's correct Steve. We're guiding to 21% for 2022.

Q - Steve Hansen {BIO 15756282 <GO>}

Perfect. Thank you. Appreciate that. And then just a follow-up on Joel's question earlier around some of the production basins. I just wanted to clarify a bit more in New Zealand. I think the guidance relatively flattish on the year, but just curious, because you didn't have a couple of large turnarounds, are there was a turnaround in the period last year? And so, is there just -- is that a conservative guidance that we can get an uplift this year or is it just the gas supply, just trying to reconcile the to?

A - Rich Sumner {BIO 22500227 <GO>}

No, it's similar to last -- the gas profile similar to last year.

Q - Steve Hansen {BIO 15756282 <GO>}

Okay. Fair enough. And then just lastly around capital allocation. You've got a good cash position here finish off G3, when should we start to think about sort of like the next stage of capital allocation in terms of comfort ability on accelerating the buyback or pursuing buy back more aggressively as the cash flow opportunities to create[ph] here?

A - Rich Sumner {BIO 22500227 <GO>}

Yeah. So we're really happy with where we are today. Our balance sheet in really good position with 8 about $800 million on the balance sheet with $465 million left to spend on G3 and we're maintaining our minimum cash balances at $300 million. So we don't see a lot of excess today. We will be generating today's methanol prices with our assets operating -- generating strong cash flow.

We're obviously going to be cautiously watching, things are still moving through a period of economic uncertainty here. But we have options for excess cash. So like you said, we can accelerate the current bid, it's still around over $100 million at today's share price. That number is getting bigger every day. And then if we can upsize the bid as well, which would mean tempers going to 10% of the public float would be another around $100 million.

And then we've said that we want to repay rather than refinance our $300 million bond coming due in 2024 and we think we can do that in stages rather than all at once. So we have options, we're going to be looking at our options and obviously first priority is to keep a strong balance sheet and through this period and ensure G3 is completed

Q - Steve Hansen {BIO 15756282 <GO>}

Thank you for the time. Thanks.

Operator

Your next question comes from the line of Jacob Bout with CIBC. Please go ahead.

Q - Jacob Bout {BIO 4826791 <GO>}

Good morning.

A - Rich Sumner {BIO 22500227 <GO>}

Hey Jacob.

Q - Jacob Bout {BIO 4826791 <GO>}

Yeah, I wanted to go back to that discussion on China and your thoughts on the low MTO affordability that we're dealing with right now. One, does that improve, because I thought part of the discussion, there was just the overcapacity situation for the Chinese olefins market given the ramp and new capacity there?

A - Rich Sumner {BIO 22500227 <GO>}

Yeah. the olefins market has been under pressure for well over a year. That's on the back of both like you said the new capacity that's been coming into the market, as well as the economic demand for olefins. So kind of a double whammy there. That's impacted the affordability for both Asian naphtha producers as well as MTO. We think MTO, it's been competitive to naphtha through that period. But it's been tough for all producers in that sector.

When it gets back into balance. It's sort of hard to predict. We think that that -- on the demand side, certainly the opening up of China could help support on the demand, but there is new capacity and required rationalization of operating rates. We don't really think, olefins pricing is so low right now, it's low low. It's hard to see it going further down from here, but we'll see how -- see what happens. So, we think there is some positive signs with demand that could help balance things out, but still need that rationalization in that industry.

Q - Jacob Bout {BIO 4826791 <GO>}

Okay. And then my second question just on the Trinidad gas contract. Maybe just talk through where you are in the negotiations are for Titan. And this contract for Atlas, will you be doing this at the same time? And then what are the structures of the gas contracts being considered?

A - Rich Sumner {BIO 22500227 <GO>}

Yes. So, for Trinidad, certainly want to be talking to the National Gas Company of Trinidad for both Titan and Atlas. The NGC is really a number of different discussions right now. One is with the upstream and so they are in discussions with the major players in the upstream there. They are also have been working towards getting a standard ownership interest across all the LNG trains. And then obviously start to the discussions with the downstream. So positive progress on all fronts. We understand, they've done one contract -- upstream contract with BP.

We also understand that they reached agreement on the unitization of the LNG and that sent to be done in the first quarter and complete. I think that both those things are creating a better environment for now us getting into commercial discussions with -- on the petrochemical side. So we will be having those discussions this year.

Some other positive news is recently is the Biden Administration just granted a license to Trinidad to develop a field, the Dragon field in Venezuela, which is a fourth Tcf field. That's positive, because there is also -- an even larger fields that borders -- it's more than double the size of the borders Trinidad in Venezuela. So it opens up the possibility for that to happen as well. So this progress happening there. We'll have more to report throughout this year as progress takes place there.

Q - Jacob Bout {BIO 4826791 <GO>}

Okay. Thank you.

Operator

Your next question comes from the line of Laurence Alexander with Jefferies. Please go ahead.

Q - Laurence Alexander {BIO 21637617 <GO>}

Good morning. Could you give some detail on how you're seeing the evolution of the Marine methanol demand and your line of sight to demand growth over the next couple of years? And what you're seeing in China for both DME and industrial boiler demand?

A - Rich Sumner {BIO 22500227 <GO>}

Sure, I'll start with the Marine Fuel. This is a really exciting area for us. We're seeing a lot of interest right now. We -- as of today, there is both ships that are on the water as well as orders that are on the books today. It's over 100 vessels that, if run on methanol, 100% of the time would be 3 million tonnes of demand. But we also know that all major shipping companies are looking at methanol, either committed to methanol or looking at methanol in the container space.

So that's Costco, HMM, Bears[ph], CMA, CGM and others. So really exciting there, but we're also seeing interest in all other sectors. Cruise lines, Disney just committed to their first cruise -- large cruise vessel. Ferry (inaudible) the first converted ferry vessel. And then we know tug barge, dry bulk, et cetera.

So we were really interested. We're supporting that area, we expect to see it grow, continue to grow. We're supporting in a number of different ways, trying to really help with shipping companies understand the technology of methanol, the logistics, the availability of methanol. We just did some demonstrations when the port of Gothenburg with Stena during the first ship to ship bunkering in Sweden, as well as for ferry. So we're supporting this in a lot of different ways and we're also trying to understand their interest in low-carbon methanol and how that fits with potentially our investments in our sites as well as future projects. So really interesting space. I'm sure we'll have a lot more to report on more vessels and more demand potential as that goes forward.

Your other question is about coal boilers and kilns. You asked about DME. DME, we don't see demand growing there, that's sort of what I'll say is sort of a mature application not seeing investments in that space, but it's sort of steady demand, above 4 million tons of demand per year with a lot of growth rates on that. Coal boilers and kilns, we see that conversions continue to happen, mainly in the smaller commercial applications for commercial heating and commercial residential heating. So continuing to track that. We put a number on it, it's probably in a 4% to 5%, it's not -- we're not seeing huge growth rates there.

The other area that we're watching is demand for vehicle fuels. Ki Lee[ph] is promoting a number of different applications, M100 vehicles, heavy duty trucks, as well as hybrid sedans. And so they have some quite optimistic marketing plans for especially heavy duty trucks. So yes, so those are the applications we're watching and continuing to track.

Q - Laurence Alexander {BIO 21637617 <GO>}

Thank you. And can you also just speak to kind of your philosophy or your view on what Methanex's strategy should be on green methanol? And also what you see is the current kind of state of the market? I think as far as to keep track, I think there's about 1.5 million tonnes of projects already announced, but I'm not sure for catching everything. So just curious about what you see in terms of -- what's in the pipeline and how you want to participate in that?

A - Rich Sumner {BIO 22500227 <GO>}

Yes. I think if you break those projects down, you'd see those are a lot of announcements that haven't reached full commercial project approval. So I think the pace of those projects is something that we're watching. As it relates to Methanex, we're looking at a number of different areas and when it relates to low carbon. First -- the first and the easiest thing for us to do is renewable natural gas. So, we're certified in North America in our Geismar plants and we're active in the renewable natural gas market where we buy renewable gas at a premium and create green methanol and supportive of downstream customers. When it comes to investments, we're looking at the feasibility of carbon capture in the US. And that's on the back of benefits and tax incentives under the Inflation Production Act, as well as sequestration availability in Louisiana.

So we're looking at the feasibility of that and we're also looking at the feasibility of e-methanol, a small e-methanol investment in our -- at our New Zealand site and we think that is something we could apply to multiple sites. These are very early, really in the feasibility stage understanding technology, understanding capital and these things will take government support as well as customer demand and willingness to pay. So I think our strategy is to try to make sure we're positioning the company the right way as those things advance and there's -- and the conditions for investment improve.

Q - Laurence Alexander {BIO 21637617 <GO>}

Thanks. And just to clarify on the biogas route. Are you making the same profit per gallon using the biogas as you are on regular gas?

A - Rich Sumner {BIO 22500227 <GO>}

So I guess the answer is, yes. And I guess the answer would also be it, it depend on each agreement we would get in. And as of right now, we're still in discussions on that.

Q - Laurence Alexander {BIO 21637617 <GO>}

Perfect. Thanks.

Operator

Your next question comes from the line of Bernard Horn with Polaris Capital. Please go ahead.

Q - Bernard Horn {BIO 1780703 <GO>}

Yes, good morning. I just have another question on the MTO market in China. You mentioned that, there was another a new naphtha cracker coming up. I just wondered if the competitive dynamics might change with a kind of shiny new naphtha cracker, will it become more cost competitive in some way that could in any way affect the demand for methanol in that market?

And secondly, there is a considerable amount of new capacity coming up. I think BASF is putting up a huge plant there. I'm not sure if they would have any offtake on -- I mean, any supply of methanol that might change the competitive dynamics of methanol in that market?

A - Rich Sumner {BIO 22500227 <GO>}

Yeah. So let me clarify what I was talking about MTO units. So the MTO side, I'm talking about is, it's all -- the MTO units on the same site as the refinery expansion. Today the MTO units is feeding into derivative downstream. They've started -- they've now built out a new refinery project on the same site, right, next door with both the naphtha cracker as well as new derivative downstream. So once all the site is fully commissioned, they actually need both in terms of feed.

When we look at economics, MTO today looks more competitive the naphtha and if you also include the fact that MTO is buying a considerable amount of product from Iran at discounted prices to international prices, that makes it even more attractive. So we would expect to see that, that plant starts up. So it's really a very site-specific issue, but it obviously has big demand impact given this MTO unit concerns over 2 million tons per year.

Q - Bernard Horn {BIO 1780703 <GO>}

Okay. Yeah. Thanks. That is very helpful. I was little confused as to what you were saying about that.

A - Rich Sumner {BIO 22500227 <GO>}

Yes.

Q - Bernard Horn {BIO 1780703 <GO>}

All right, thanks. And anything on the BASF plant and other big chemical expansions there, whether they might in some ways produce by product of methanol and in anyway that would affect the competitive market for methanol in China?

A - Rich Sumner {BIO 22500227 <GO>}

Not familiar with that, but certainly -- I mean what we're seeing is not the expansions. We consider that in the mix of all the capacity that's being added, I'm sure, but nothing specific to mention around that.

Q - Bernard Horn {BIO 1780703 <GO>}

Thanks very much. Have a good day.

Operator

(Operator instructions). Your next question comes from the line of Joshua Spector with UBS. Please go ahead.

Q - James Cannon {BIO 16169295 <GO>}

Hey guys, this is James Cannon on for Josh. Just looking at kind of where gas costs have come down to at this point in 2023. You starting to hear some comments on potential reopening and not reopening, but improvement in Europe as things become more affordable and potentially seeing some rebuild in feedstock inventories of the downstream production. Can you comment on what you're seeing in that market versus what we're seeing through destocking in 4Q?

A - Rich Sumner {BIO 22500227 <GO>}

So yeah, I guess when we talked about our fourth quarter, our fourth quarter we saw traditional chemical applications declined about by about 3% and a lot of that was driven by both Europe and Asia. Right now certainly, we think that the decrease in natural gas prices supported producers and manufacturing base in Europe.

As of right now, we would say that, it's likely got a little upside from where we were towards the end of the year, but we got to wait and see. I think our customer base is a little more optimistic than what they were three months ago. So, but still got to wait and see and see how operating rates are impacted, but I'd say modest improvement in outlook there.

Q - James Cannon {BIO 16169295 <GO>}

Okay. Thank you. And then just as a follow-up to that, with gas now below 250 in the US. Do you have any update to your kind of views on your hedging strategy with '23 at 85% and how we should think about looking out 2024 and beyond?

A - Rich Sumner {BIO 22500227 <GO>}

Sure. So, when we think -- you quoted, we have 85% hedged. When we look at our North America natural gas exposure, we consider both Medicine Hat and Geismar in our North -- in mix of North American gas. We have a team that looks at how we want to manage that on an active basis. Our target is to have around 75% per year hedged for us there.

We view that in two ways. One is through longer term fixed price physical contracts with suppliers. And then the second is through commodity hedging in the financial markets. We're hedged 85% for 2023 and then we're close to our 70% levels for both 2024 and 2025 after considering G3 at full production rates. So we feel really good where we are in the kind of medium-term. We're going to continue to be active in the market. Obviously today's spot price is supporting our unhedged exposure and that's quite a benefit from where we were last year when we saw that pricing up in the $8-$9 in mmbtu. So we think that's a positive for our cost structure in 2023.

Q - James Cannon {BIO 16169295 <GO>}

Okay. Great. Thank you.

Operator

There are no further questions at this time. I will now turn the call back over to Mr. Rich Sumner.

A - Rich Sumner {BIO 22500227 <GO>}

Thank you for your questions and interest in our company. Looking forward, we are well positioned with our current asset portfolio and a strong balance sheet. Our G3 project is fully funded, progressing safely on time and on budget and we expect to be in production in the fourth quarter of this year. We hope you will join us in April when we update you on our first quarter results. Thank you.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you all for joining. You may now disconnect.