THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MX.TO - Q2 2016 Methanex Corp Earnings Call

EVENT DATE/TIME: JULY 28, 2016 / 4:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Sandra Daycock *Methanex Corporation - Director, IR*

John Floren *Methanex Corporation - President & CEO*

Ian Cameron *Methanex Corporation - SVP Finance & CFO*

CONFERENCE CALL PARTICIPANTS

John Roberts *UBS Securities LLC - Analyst*

Joel Jackson *BMO Capital Markets - Analyst*

Steve Hansen *Raymond James LLC - Analyst*

Daniel Jester *Citigroup Global Markets - Analyst*

Jacob Bout *CIBC World Markets - Analyst*

Cherilyn Radbourne *TD Securities Inc. - Analyst*

Hassan Ahmed *Alembic Global Advisors - Analyst*

Duffy Fischer *Barclays - Analyst*

Robert Kwan *RBC Capital Markets - Analyst*

Charles Neivert *Cowen and Company - Analyst*

Brian Lalli *Barclays - Analyst*

Chris Shaw *Monness Crespi Hardt & Co. - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Methanex Corporation Q2 2016 earnings call.

I would now like to turn the conference call over to Ms. Sandra Daycock, Director of Investor Relations. Please go ahead, Ms. Daycock.

Sandra Daycock - *Methanex Corporation - Director, IR*

Thank you. Good morning, ladies and gentlemen. Welcome to our second-quarter 2016 results conference call. Our 2016 second-quarter news release, Management's Discussion and Analysis, financial statements and presentation slides summarizing the Q2 results can be accessed from the Reports tab of the Investor Relations page on our website at www.methanex.com.

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

Certain material factors or assumptions were applied in drawing the conclusions or making the forecast or projections, which are included in the forward-looking information. Please refer to our second-quarter MD&A and to our 2015 Annual Report for more information.

I would also like to caution our listeners that any projections provided today regarding Methanex's future financial performance are effective as of today's date. It is our policy not to comment on or update this guidance between quarters.

For clarification, any references to revenue, EBITDA, cash flow, or income made in today's remarks, reflect our 63.1% economic interest in the Atlas facility and our 50% economic interest in the Egypt facility.

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

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

John Floren - *Methanex Corporation - President & CEO*

Thank you, Sandra.

The second quarter of 2016 was another challenging quarter for the methanol industry and our company. During the quarter we reported adjusted EBITDA of $38 million and an adjusted net loss of $31 million, or $0.34 loss per share on a diluted basis. The higher EBITDA in Q2 is primarily the result of a higher produced sales volume, as our average realized price decreased from $230 per tonne in Q1 to $223 per tonne in Q2.

During the quarter we recorded a $32.5 million pretax gain related to the termination of Petrobras's natural gas delivery obligations to our facilities in Chile. This has been excluded from adjusted EBITDA and adjusted earnings.

Methanol prices were stable in the second quarter, and price differentials across global marketing regions were relatively narrow. We estimate the current cost curve to be $220 to $230 per tonne, which is consistent with the spot pricing in China today.

Our posted prices for August in both Asia and North America remain unchanged at $275 per tonne and $266 per tonne, respectively. Our Europe price was adjusted upward EUR15 per tonne in Q3 to EUR240 per tonne, which is roughly in line with the prices in the other two regions.

Overall methanol demand growth was solid in Q2. We estimate total Q2 demand at 16.5 million tonnes, representing a year-over-year industry demand growth rate of around 8%.

Methanol to olefins, or MTO, demand was the biggest contributor to growth, as one new plant ramped up to full operating rates and other plants increased their operating rates as a result of improving margins. The strong demand growth in Q2 was mostly met by improved supply, as a number of plants returned from maintenance outages, as well as there was a reduction in global inventory.

There are now a total of 14 completed MTO and methanol-to-propylene, or MTP, plants that have the capacity to consumer over 14 million tonnes of methanol at full operating rates. We continue to expect an additional three MTO plants to be completed in the coming months, with a capacity to consume up to 4.5 million tonnes of methanol at full rates.

We estimate that during the quarter approximately 6 million tonnes of annualized methanol demand was not realized due to core methanol affordability for MTO, MTP, dimethyl ether, or DME, and methanol-to-gasoline, MTG.

We announced in April that our subsidiary, Waterfront Shipping, had taken delivery of three new 50,000 tonne deadweight vessels capable of running on methanol. One more vessel was delivered at the end of June, with the remaining three vessels to be delivered in the coming months. We expect these innovative new vessels will prove that methanol is a viable, biodegradable, clean-burning marine fuel that reduces ambient emissions. We expect this application for methanol to be a growing source of demand for years to come.

Our plants ran extremely well during the quarter and achieved a new record quarterly production of close to 1.8 million tonnes compared to 1.6 million tonnes in Q1. We also had record sales volume of just under 2.4 million tonnes.

We achieved plant reliability of 97% during the first half of 2016. Our global team has done a great job in meeting our Company reliability target and ensuring reliability and safety are top priorities.

As was the case in Q1, our EBITDA did not see the full benefit of this higher level of production in Q2. Production exceeded sales of produced ethanol by approximately 81,000 tonnes, which is just over 10% of our average produced methanol inventory.

Our Geismar plant operated very well this quarter, which reflects the excellent reliability of these assets, as well as the relatively new age of the catalyst for each facility.

Our Medicine Hat plant experienced a very unusual mechanical issue during the quarter which resulted in lost production of about 40,000 tonnes. The plant is back online.

In New Zealand our facilities ran at an annualized rate of 2.3 million tonnes. We are of this excellent performance and it reflects the ongoing investments the Company is making to improve the reliability of the three plants.

We had additional good production news in Egypt, as we did not expect the plant to produce methanol in Q2, and only to return to operation after the peak summer electricity demand period had passed. As gas became available we were able to restart the plant in May 2016 and operate intermittently at reduced rates.

This is an excellent example of the agility of our Egypt team demonstrates every day in an environment where it's difficult to predict when gas might become available to run our operation. We are operating today and continue to anticipate that the plant might have to shut down intermittently during the remaining summer months when electricity demand is at its peak.

Chile production in Q2 was higher than expected, as 73,000 tonnes of methanol with gas sourced 100% from Chile. For the first time since 2012 the Chile site produced methanol during the Chilean winter months of June and July, a time when local gas consumption increases. The Chile 1 plant has sufficient supply to run through July, but was idled early in the month for scheduled maintenance and is expected to restart in August.

We continue to be optimistic that Chile represents our lowest-cost growth opportunity. As further progress is made in lowering the cost of developing Chilean gas reserves, we are optimistic that additional competitively priced gas could become available in the near future. We are in continuous discussions with gas suppliers to secure additional gas to be able to run our operation at higher rates.

In addition, the Argentinean government has published a decree authorizing certain exports of surplus gas on an interruptible basis. This is another positive indication for potential additional gas supply to our Chile operation. We expect that very modest capital investment would be required to restore the Chile site to a long-term, two-plant operation.

In Trinidad we continued to experience gas restrictions of approximately 15% during Q2. Our Atlas facility returned to production following a 45-day turnaround in Q1. We expect slightly lower rates in Trinidad in Q3 due to increased gas restrictions.

We ended the quarter with $239 million in cash. Methanex's share of the cash, including our proportionate share of the Egypt and Atlas cash, was $208 million.

Our cash balance declined in the second quarter primarily due to a build [of] working capital as a result of higher sales volume and an inventory build to support our higher sales portfolio. At current Q3 contract prices we expect cash generation, excluding any impact from working capital, to be sufficient to cover debt service requirements, maintenance capital, and our dividend.

Our asset portfolio has never been in better shape. Currently we are very leveraged to a recovery in methanol pricing from the bottom of the cycle. In this current uncertain market environment we remain focused on prudent cash and cost management.

Our cost reduction initiatives have resulted in an annualized saving of $32 million in fixed costs based on what has been achieved in the first half of 2016. We have very limited cash requirements or financing commitments in the near term, and expect to spend approximately $25 million on maintenance capital during the remainder of 2015.

Our outlook for the third quarter is more positive than the first and second quarters. With production and sales at record levels and prices expected to be higher in Q3 than in Q2, we expect EBITDA to be higher in Q3 2016 compared to Q2.

I would now be happy to respond to any questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) John Roberts; UBS.

John Roberts - *UBS Securities LLC - Analyst*

Could you give us an update on the Chinese MTO, MTP situation right now? And with coal rising and oil and naphtha coming down, are you expecting any changes because of that changed dynamic between the two different marginal feed stocks?

John Floren - *Methanex Corporation - President & CEO*

So the MTO plants in China have been running quite well, at high rates. The MTP plants are still a bit stressed with the current propylene prices. So they've been running at low rates. So overall, around 65% rates for the olefin plants in China.

The feedstock for these plants and for our other plants changes all the time. Coal is up marginally, but really not enough to impact the cost curve in a significant way. And we haven't seen naphtha or even propane rise to the extent that oil's risen. If you look at the historical ratios between those products, even though we've seen oil move up by about $10 a barrel, we haven't seen any real move in naphtha or propane, which is one of the reasons why we saw the affordability for some of the derivatives in the second quarter still be challenged and about 6 million tonnes of demand not materialize as a result.

Operator

Joel Jackson; BMO Capital Markets.

Joel Jackson - *BMO Capital Markets - Analyst*

Just a couple questions. First, so if the current contract prices were to hold for indefinitely or for a while here, are you still comfortable in this dividend rate, John? And you answer this question every quarter, but maybe give us an update on that and what would have to happen for you to have less confidence in the dividend's current rate. Thanks.

John Floren - *Methanex Corporation - President & CEO*

Yes. So at current contract pricing we, as I said, would expect to be able to maintain the dividend, no problems at all. So we have enough cash generation to cover the maintenance capital, the dividend, and our debt service. So really no worries about the dividend at all.

And as I said one or two calls before, I think before we would consider even looking at the dividend, we'd have to see a lot lower methanol prices than we saw in Q2 for a lot longer period.

So the cost curve, again, looks to have been pretty accurate, working as expected. And pricing will be better in Q3, so really no worries about the dividend at all at this point.

Joel Jackson - *BMO Capital Markets - Analyst*

Okay, that was helpful. And the second question, I'll sneak in a two-parter, both on Egypt. Can you talk a little about what the conditions have been in Egypt, such that you can't -- there's restrictions on share distributions for the cash in that JV. And then also, you've had some gas this summer in Egypt when the last couple years you haven't. What's been different this year? Thanks.

John Floren - *Methanex Corporation - President & CEO*

Sure. So that's three questions, Joel, but that's okay. So Egypt and the cash distribution, there's certain covenants in our debt agreements with project financing that one hasn't been met. And therefore we're restricted from taking the cash out of Egypt.

Having said that, we need cash in Egypt as well. So the cash is there. It's available for use in Egypt. And as things improve in Egypt we hope and expect to be able to get this covenant met. So that's our expectation, but it will probably take some time.

As far as gas availability, well the government's been doing a lot of great things to improve the gas availability in Egypt. With the second (inaudible) plus importing even gas from Jordan (inaudible). So they have been using a pipeline. And they're doing a lot of other things to improve gas availability, like changing some of the electricity generation to combine cycle units and removing some subsidies. So they're taking a lot of steps, really started 12, 18 months ago, to improve the situation.

Part of the issue was cash availability in the country as well, which has improved. So as they have cash they can buy more LNG cargoes, which improves the gas situation.

As we meet with the government, they were pretty clear in our last meeting with them that they think 2015 was the worst year of gas supply for the country, and they expect it to get better going forward. And that's what we've seen. So every time we've met with the government, what they say is usually what happens pretty accurately.

So we've been cautious about how much gas might be available. We're still cautious going forward. But our view is things have improved. And we think with the large discoveries just off the Mediterranean from our plant, that as those get developed over the next few years, the medium term operating rates should get a lot better in Egypt.

So little bit more optimistic but still lots of moving parts. And here we are, whatever it is, July 27th, running in the height of their summertime, when they need more gas to produce electricity for cooling. So I think it's positive.

Joel Jackson - *BMO Capital Markets - Analyst*

Thank you for that.

Operator

Steve Hansen; Raymond James.

Steve Hansen - *Raymond James LLC - Analyst*

John, can you just help us understand the inventory build issue again? I think you've spoken about this in the past but, again, the 80,000 tons that you've held back here versus your production levels. Just trying to get a sense for what the cadence should be on a go-forward basis from here. Thanks.

John Floren - *Methanex Corporation - President & CEO*

Yes. What I've guided to over the last number of years as we've been building out our production portfolio -- we've added 3 million tonnes in just about three years. And if you'll recall, three years ago a big part of what we were selling was actually purchased product. So I think it got as high as 40%, if I recall, maybe even a bit higher.

So what I was saying, as we're adding in this new production don't expect our sales to go up to the sale level. As a rough guidance we'd like to see selling about 80% of our own produced product and about 20% combined spot purchases and long-term outtakes.

And if you look in the quarter, if you look at what we sold and what we produced, it's been around 75% of what we sold was our own produced product. So as we've added in this new production we've increased our produced inventory and we're probably pretty close to the target we want to be at now as far as the amount of produced in our inventory and the amount of sales. So I think going forward this produce build, as we've called it, is pretty well behind us.

Steve Hansen - *Raymond James LLC - Analyst*

Okay, that's helpful. And just maybe some additional color on the Chilean side of things, the Argentinean decree, for example. Like to hear a little bit more about that if you could and just maybe how we should think about the cadence of that plant once, again, it comes up off the current maintenance schedule.

John Floren - *Methanex Corporation - President & CEO*

Sure. So the decree is relatively new. But I think we heard from the Argentineans that there is excess gas available, especially in the Southern Cone during certain periods of the year, i.e., their summertime. So I think the decree is another step in the right direction, that the government is going to allow for exports of gas in certain parts of the country in certain times of the year.

So we don't have any Argentinean gas today. We're not in any real short-term conversations to expect to get Argentinean gas in the next weeks. But when we talk to the producers in the Southern Cone they do have excess gas and with this decree I think it will allow now for negotiations to see if we can access that gas at certain times of the year at economical prices.

So I think the impediment of the government not allowing exports or putting very high tariff on exports is starting to unthaw. So I think it's very positive, because the more gas that we have to access in that region, I think the better rates will run in the more competitive environment, which should lead us to get economical gas to run the plant at higher rates.

The mechanical work we're doing on the plant in July will allow us to run at higher rates as gas becomes available. And I mentioned earlier we think that more gas is going to be available so we expect to be running the plant at higher rates as we come out of this turnaround.

Steve Hansen - *Raymond James LLC - Analyst*

Okay. Very helpful. Thanks.

Operator

Daniel Jester; Citi.

Daniel Jester - *Citigroup Global Markets - Analyst*

So you called out that there's three NGL plants that could start later this year. Do you have any sense as to the potential timing?

And then, what's your outlook for any additional MTO capacity in 2017?

John Floren - *Methanex Corporation - President & CEO*

So we don't have anything in our own demand portfolio except for these three. There's another bunch that have been announced, probably not under construction at this point. So I think these three are the last three until you see a different set of economics in the MTO space.

All three have continued to move forward. They're not delayed because of economic reasons, which you might have read in some of the trade journals. Our information is there have been some mechanical issues and in one plant's case, a bit of a cash availability issue and some issues to do with management. But we expect these plants, as I mentioned, to come on in the coming months. And we'll continue to monitor them and see how they progress.

Daniel Jester - *Citigroup Global Markets - Analyst*

Okay. And then, on the 8% demand growth in the second quarter, can you just break that our sort of MTO and energy-related demand versus traditional demand? And maybe talk about what you're seeing on the traditional demand market, maybe on a regional basis? Thank you.

John Floren - *Methanex Corporation - President & CEO*

Yes. So traditional demand rose GDP, IP. And I think we all know that those numbers have not been that stellar in the last couple of quarters. But the traditional demand growth year over year in the second quarter was 3%. And the energy demand growth, which is mainly MTO, but there were some other sectors that grew as well, was 17%.

Daniel Jester - *Citigroup Global Markets - Analyst*

Great. Thank you very much.

Operator

Jacob Bout; CIBC.

Jacob Bout - *CIBC World Markets - Analyst*

Wanted to go back to Chile and the timing of the Petrobras settlement. Why was it settled at that point? And maybe talk a little bit about the potential for other settlements. I know there were a number of other gas suppliers.

John Floren - *Methanex Corporation - President & CEO*

Yes. So the Petrobras settlement -- we've been in arbitration with Petrobras for some time. I think we were getting close to the actual hearings happening. At the same time, they wanted to sell their Argentinean business. And I think when you go to arbitration -- you know, I thought we had a strong case. And that's why we pursued it. But there's no guarantees. So I think we had a willing party on the other end that wanted to settle and we thought it was appropriate to try and get a settlement as well.

You know, our interest down there is to get gas. It's not to arbitrate. It's not to take people to court. Our interest is getting gas. And I think a lot of the suppliers down there were very cooperative in trying to find ways to get gas. And some of that work that we were working with these partners on is coming to fruition to get more gas. And a lot of gas according to the US Geological Survey in that Chile Basin.

So I think the timing is just because we were getting close to the actual hearing and there was probably a motivated party for other reasons.

We'll continue to pursue all of our rights under our gas contracts. And our first prize is to get more gas. And that's what we're working on.

Jacob Bout - *CIBC World Markets - Analyst*

Okay. Maybe can you provide a little bit more detail on the pricing and what structure these gas contracts could look like (inaudible)?

John Floren - *Methanex Corporation - President & CEO*

Yes. So we're not looking to have sharing kind of arrangements in these contracts. We're looking for a base price that allows us to run our plant or plants at the bottom of the methanol cycle. And that's obviously also good for the supplier, that they can also make a return.

So all parties have to win for things to be sustainable when I'm talking about a 10-year operation. So I think we're looking at economics that makes a lot of sense even at today's price of methanol. So pretty optimistic but some more work to do.

And I think the suppliers themselves have to continue to get their costs down. And we've seen tremendous improvement in the costs of the tight gas over the last few years. And we would expect people like Conoco Phillips come into the basin, start horizontal drilling, costs have continued to improve. So that's what we saw in the US and that's what we see in Chile, and it looks very optimistic at this point.

Jacob Bout - *CIBC World Markets - Analyst*

Last question here, just on the marine fuel. What is current demand right now and what do you expect that to grow by over the next year or two?

John Floren - *Methanex Corporation - President & CEO*

I would say negligible. We've got our three ships lined out and Stena's got the one ferry. So I think it's a rounding error at this point. It's a huge potential. You're talking tens of millions of tonnes. I think there's a lot of people right now on the sidelines watching how we do with the MAN engines. And Stena has done very well with the Wartsila engines. And as a result we're seeing a lot more interest from cruise ships and smaller tugboats and many different projects now on the way to prove out this technology.

So we're still at the -- on a scale of 1 to 10 we're probably stage 1 or stage 1.5. Big demand potential and as the regulations continue to tighten up for NOx and SOx as well as particulate matter, methanol is a great alternative fuel to meet these new standards that are coming in in coastal regions and probably more widely as IMO has indicated in the next decade.

So we're just at the infancy stages, proving up the technology. But I think the future of this fuel onboard ships is quite interesting and will probably build to a pretty nice market over the next 5 to 10 years.

Jacob Bout - *CIBC World Markets - Analyst*

Thanks a lot, John.

Operator

(Operator Instructions) Cherilyn Radbourne; TD Securities.

Cherilyn Radbourne - *TD Securities Inc. - Analyst*

Your plant reliability year to date has been very strong. Just wondering if you can talk about what else you've been doing internally to control logistics and overhead costs as you navigate this low part of the cycle.

John Floren - *Methanex Corporation - President & CEO*

So logistics has always been a strength. But we continue to improve there as far as the backhauls. And as we're bringing product from the Atlantic Basin into Asia there's potential for other backhauls which we've secured for products like benzene. So our logistics and shipping team do an outstanding job in minimizing costs and looking for revenue opportunities to maximize our ships. So that continues to be a strength.

You're right to point out our reliability has improved. We've been working hard at it for a number of years, and making investments. We started up three plants in New Zealand which had been down for a long time and need investment. Medicine Hat as well needed an investment, which we made last summer.

And remind you, our Egypt and Trinidad plants get gas on an intermittent basis. And these plants hate that. They like to run full out and very steady. When they go up and down, that's when you have issues and that's what we've experienced. But we've been getting better at understanding how to bring these plants up and down. So I think it's a bit of experience there.

So I think a number of issues that we've been working very hard on and I know our team has been extremely focused on improving our reliability and for the first half of the year, it's been outstanding. So we're really pleased with that.

As far as other initiatives, we've delayed some hirings. As people retire or move on we're really taking a hard scrub on whether we need to replace that person in the short term. We've cut some of our travel around the world, using video technology much more extensively. And reduced a bit of our training in the short term.

So we're doing things that we think are prudent in the short term, including maintenance capital, which we've reduced from about 80 on average per year to about 50 this year. So none of these things that we're doing are probably sustainable on a long-term basis, but for a one-to two-year basis, we think they're the right things to do to conserve cash and be prudent in what's a very tough economic environment.

Cherilyn Radbourne - *TD Securities Inc. - Analyst*

Great. And then my second question is, as you are probably aware, one of your peers made some comments on their call earlier this week about some of the MTO units that are still to come on, those being more world scale and therefore having unit costs that are more competitive with the other ethylene producers, which has the potential to be positive for methanol demand. Can you just talk about whether you agree with that perspective?

John Floren - *Methanex Corporation - President & CEO*

Well, when we look at the cost curve for the olefins market, with the very low naphtha prices that we're seeing today, like, under $400 a tonne -- when oil was $80, $90 they were $1,200 a tonne -- that's really what's changed the shape of that cost curve. So even with methanol at much lower prices than we see today, naphtha at $400 or less is certainly a more competitive feedstock for olefins.

But I think these plants that are coming on will be cash positive in the current environment and probably making a fairly good cash margin as the MTO plants that are running today are. The only ones that really under some stress are the methanol to propylene on-purpose plants. And the three that are coming on are all integrated to olefins so methanol -- sorry -- ethylene and propylene, so that aspect compared to some of the MTPs, they would have better economics as far as affordability for methanol. So that we would agree with if they were comparing just the existing MTP [plants].

So the cash margins are pretty good today at current methanol prices. So we believe there is room for methanol prices to increase and not impact the affordability on the MTO plants if everything else remains the same -- which of course it won't. So we watch it every day and every week.

Cherilyn Radbourne - *TD Securities Inc. - Analyst*

Great. Thank you for the time.

Operator

Hassan Ahmed; Alembic Global.

Hassan Ahmed - *Alembic Global Advisors - Analyst*

John, just wanted to revisit the MTO side of things. Obviously the last couple of quarters with oil volatility, with ethylene pricing volatility, a lot of the sort of newer facilities were not starting up. So probably these guys were waiting for the right time, right pricing to start these facilities up.

Now going forward, what's your view in terms of operating rates? Meaning is it fair to assume that once these facilities start up they from get-go run at elevated operating rates? Or will the operating rates of these MTO plants sort of bob and weave with sort of the ebbs and flows in oil and ethylene prices?

John Floren - *Methanex Corporation - President & CEO*

I think there's been a lot of confusion about operating rates in this space. And a lot of it has been mechanical issues as well. These are large integrated facilities that have upwards of 10, 15, 20 different derivatives associated with producing olefins that they're making other products with. And most of the trade journals just say when the operating rate is X it's all because of economics.

Well, that's not true. I mean, there's a lot of mechanical issues that happen and would expect to happen as you have a lot of new facilities with a lot of moving parts and different derivatives. So I again would reiterate what we believe, that if you take economics out of it, that these sites should run around 85%, 90%. And that's what we model going forward. We've never modeled 100%. Because there will be [lining] out issues over the coming years as this new technologies gets introduced in all of the other derivatives.

As far as economics, I've mentioned the MTP is really under pressure because of the PDH units that have come up, which has imbalanced that market versus what it used to be like. And so as that works its way out, you would expect maybe go back to more historical levels for propylene pricing. But that's to be seen.

So we'll continue to monitor it on a regular basis and adjust accordingly.

Hassan Ahmed - *Alembic Global Advisors - Analyst*

Got it. Now, on the demand side of things, John, you talked about sort of traditional demand kind of hanging in there at sort of 3% growth year on year. Now a couple of days ago Celanese reported earnings and, as you know, obviously one of the larger producers of acetic acid. And they talked about their production for acetic, Q1 to Q2 being down 11%. So my question is that if you guys are seeing sort of normal demand from the traditional demand sources like acetic while Celanese is seeing 11% volume declines in acetic Q1 to Q2, do you think at these low prices there is an element of inventory build that's going on amongst these guys?

John Floren - *Methanex Corporation - President & CEO*

Methanol inventory build?

Hassan Ahmed - *Alembic Global Advisors - Analyst*

Correct.

John Floren - *Methanex Corporation - President & CEO*

I think there's been an inventory drop. Our numbers in Q2 show a fairly significant inventory drop in the global methanol inventories, based on our numbers. Looking at acetic acid in particular, we saw the market grow year over year by about 100,000 tonnes in the quarter. So we saw a little bit of growth. I can't comment on Celanese's specific situation in their business. They're best to comment on it. But we are continuing to see growth in acetic acid to the extent of about 6%.

So that's what our numbers show. And we have a database that tracks every single methanol plant and every single derivative plant around the world. And we have a team that spends a lot of time on disseminating this data. So we're not showing -- I don't have the specific numbers for Celanese out of this database, but as far as acetic acid itself we saw growth.

Hassan Ahmed - *Alembic Global Advisors - Analyst*

Very helpful, John. Thank you so much.

Operator

Duffy Fischer; Barclays.

Duffy Fischer - *Barclays - Analyst*

Wanted to ask on the fuel end markets, DME and direct blend into transportation fuel, in China in particular. How would you gauge the affordability there? And what do you think the growth rate has been year to date for those two markets?

John Floren - *Methanex Corporation - President & CEO*

So DME is really not going into any transportation fuels per se. Most of the DME demand that's in China is really for propane substitution. So the demand there has been pretty flat I would say, 20% of propane substitution for burning. And that's been pretty flat.

As far as fuel blending goes, we've seen a modest increase in fuel blending, 2%, 3%. The affordability is still quite strong even at the current gasoline prices in China. So we would expect that demand to continue to grow.

Duffy Fischer - *Barclays - Analyst*

Okay. And then, just to jump back to the ships that you've got online, it's early days, but are you seeing the fuel efficiency that you would have expected from the ships you've taken? And is there a way -- just rule of thumb, one additional ship would consume roughly how much methanol in a given year?

John Floren - *Methanex Corporation - President & CEO*

Yes, so if we ran the ship 100% of the time on methanol -- I'll remind you that these are flex fuel; we can run a variety of fuels on these ships, and that's the beauty of this technology. It's about 30,000 to 40,000 tonnes per year if we ran it 100% of the time.

It's too early on our own ships to give you any data. Our teams are still lining out the new technology. It'll probably take us about six months to get any meaningful data. But I would say the data we're getting from Stena is very promising, and better on the emissions and efficiency than what we were anticipating as we went into this venture. So a little early for our ships, but the data from Stena is really encouraging.

Duffy Fischer - *Barclays - Analyst*

Great. Thank you, guys.

Operator

Robert Kwan; RBC Capital Markets.

Robert Kwan - *RBC Capital Markets - Analyst*

John, if I could just come back to the vessels you've taken and then some of the comments you made earlier on logistics. I'd say historically it seems like those have provided you pretty good optionality to capture pricing, logistics, move things around. I guess just given that you've grown production within the Company quite significantly, as well as in different geographies, have you felt constrained in the logistics side? And will these ships help you kind of move products to higher (inaudible) markets?

John Floren - *Methanex Corporation - President & CEO*

No, we haven't been constrained on shipping at all. I'll remind you in 2008 we lost our Chile operation, with 3 million to 4 million tonnes, depending on the particular period. And that left us long in shipping. And our team did an outstanding job at that time, which could have been a $50 million per year hit if those ships weren't utilized. And they did an outstanding job in starting to find backhaul cargoes. At that point in time we were doing very little backhaul.

And sounds easy, backhaul, but there was a lot of learning that had to go in to how to clean these ships. Once you carry another product and cleaning back so that you can load with methanol and remain on spec and not have any contamination, it sounds easy but it's really hard. There's a lot of art in it as far as which detergents, which cleaning products to use. And our team has done an outstanding job and really first class now at doing this kind of work.

And these new ships that we've taken ownership of, not only are they able to run on methanol, but the amount of fuel they would need for the same amount of voyage is a lot less. The cleaning equipment that we installed on these ships allows us to reduce the cleaning times.

So all of these efficiencies don't show up anywhere except in the cost of goods and on the bottom line. So I'm really pleased with our shipping group and our logistics and supply chain. I think we'll continue to see improvements in backhauls and the way we do things -- continuous learning and getting better every day. So really pleased with that group.

Robert Kwan - *RBC Capital Markets - Analyst*

Right. Just based on kind of what your thoughts are then in terms of the efficiencies on the new ships, is there any kind of general goalpost that you could put out with respect to what you think the cost savings might be, or the efficiency savings?

John Floren - *Methanex Corporation - President & CEO*

Yes, we have estimated efficiency savings. But let's get a few months under our belt before we give numbers. Let's make sure that what we expect is what we're getting as far as those things. But they're not insignificant.

Robert Kwan - *RBC Capital Markets - Analyst*

Fair enough. If I could just finish -- I know at these prices it probably doesn't necessarily make a lot of sense to move forward. But is there any update on a potential Medicine Hat expansion, specifically any discussions, or further discussions, that you're having with the government around Alberta's plan to try to add infrastructure around energy value-add?

John Floren - *Methanex Corporation - President & CEO*

Yes, so you're right; at these prices it seems like foolish to even think about putting in new production. But the market grew 8% year over year. And we're at the bottom of the cycle and we don't expect to be here forever. It feels like when you're at the bottom -- it feels like you're never going to get out. When you're at the top you're never going to get to the bottom. But that's the commodity business that we choose to operate in.

So we continue to have teams working on both the Medicine Hat expansion and the Geismar expansion. And those are privileged projects. The economics on those, nobody would be able to match, what we're able to do in both Medicine Hat and in Geismar.

So we're continuing to go forward on those. We're not spending a lot of money except for internal resources. So we're not out there having a lot of what we'd call a front-end engineering design. But we're getting ready to do so, when we think the timing is right that we can execute on one or both projects.

So there's been a lot of talk of new potential supply coming on in other places. But when I look at the numbers that they're using for building and constructing these plants, on a non-lump-sum basis our projects are far superior. And we're going to be in a position to execute on those projects very quickly as market conditions change.

So don't think that Chile is the only growth opportunities that we're talking about. We have teams that are really getting us set to have these projects executed in a very fast and efficient way once we think the timing is right.

Robert Kwan - *RBC Capital Markets - Analyst*

That's great. Thanks very much.

Operator

John Roberts; UBS.

John Roberts - *UBS Securities LLC - Analyst*

Just a follow-up question on the Chinese MTP and MTO plants. They compete against PDH units. And there's a fair amount of talk about increased US propane exports to China for PDH. Do you think MTP, MTO could stay underutilized for really an extended period here with PDH potentially ramping more?

John Floren - *Methanex Corporation - President & CEO*

Well, I think the PDH that's been under construction has come on, so I guess there's always the potential for more. But, again, to answer your question you've got to give me what's your five-year outlook for propane and naphtha, and obviously methanol, because all of those will play into what the relative economics are. So it's very difficult to find a producer of olefins today. Obviously cheap ethane is the US is a no-brainer. That's why you're seeing quite a few crackers being built at quite some billions of dollars. But beyond that you have to have a view of what's methanol price, what's propane price, and what is naphtha price. And therefore you have to have a view on oil and do those historical ratios stay in play.

And I think nobody has the crystal ball to know that. So I think a lot of people are making bets on both sides of that equation and we won't know until we see what happens in the future.

John Roberts - *UBS Securities LLC - Analyst*

Just a clarification -- your understanding is that propylene from PDH units in China are fully ramped right now?

John Floren - *Methanex Corporation - President & CEO*

Well, the ones that have been built are certainly competitive and running. I don't follow it -- I'm not an expert in PDH, but I'm probably going to have to take that offline to get you a more detailed answer on that one, because I don't have that data in front of me.

John Roberts - *UBS Securities LLC - Analyst*

Thank you.

Operator

Charles Neivert; Cowen.

Charles Neivert - *Cowen and Company - Analyst*

Two quick questions. One, in terms of Stena, do they have or have put out any more plans to do any more ships? Or how long will the ships that they're using be in test to see what decision they might make going forward? Is there any timeframe around that?

And then second question is, going back over time the split of the old markets, the conventional chemical markets and the fuel markets has been shifting more and more to fuel. Where are we now on that split?

John Floren - *Methanex Corporation - President & CEO*

So the traditional demand represents about 60% of the overall methanol demand. And the energy demand represents about 40%. We would think that would go to 50/50 over the next few years, is our numbers.

Charles Neivert - *Cowen and Company - Analyst*

And what's part of the fuels, do you consider -- is MTBE old or new, I mean, things like that. I mean, certain ones are obvious but where is MTBE?

John Floren - *Methanex Corporation - President & CEO*

It's in the fuel or the energy space.

Charles Neivert - *Cowen and Company - Analyst*

Okay.

John Floren - *Methanex Corporation - President & CEO*

There's six different products -- or six different ways, including MTO, that we include as an energy kind of product, where we're competing with other energy sources.

As far as Stena, they announced 25 ships that they wanted to convert. They've done one. I don't think there's any imminent plans of doing any others as a result of the current economics. But they're very pleased with the results they're seeing on the ship as far efficiencies and pollution or emissions go.

So I think we'll continue to see ships use methanol but, as I said earlier, we're probably, on a scale of 1 to 10, 1 or 1.5 in the adoption of this technology.

Charles Neivert - *Cowen and Company - Analyst*

Okay. If I could sneak one more in, Argentine gas used to provide, what, something like 60%, or two-thirds of your Chile, when you had four units down there. As far as you know, is there still that much gas available? Or are they shipping some of that north? Or what's happened to that? Obviously it's not being used by you guys, but where is it? And obviously, with the change in rules maybe it becomes available. But is there that much left?

John Floren - *Methanex Corporation - President & CEO*

Well, quite a bit of it went north, as you pointed out, but a lot of it didn't get developed. At the low prices that the producers were getting, it's staying in the ground.

Charles Neivert - *Cowen and Company - Analyst*

Okay.

John Floren - *Methanex Corporation - President & CEO*

So it becomes -- it's always economics. Can I make $1 doing whatever? And this is it. So if you get back to a more open market, for lack of a better description, then economics will prevail. And we think we can pay a price for gas in Chile and Argentina that makes it economical for these reserves to be developed. But time will tell.

Charles Neivert - *Cowen and Company - Analyst*

And all the infrastructure remains intact, so it's still usable (inaudible).

John Floren - *Methanex Corporation - President & CEO*

Yes. As recently as last year we were taking gas from YPF on a regular basis. All the infrastructure is there, and [I blend] there and it's recently been delivering gas to our site.

Charles Neivert - *Cowen and Company - Analyst*

Okay, great. Thanks very much.

Operator

Brian Lalli; Barclays.

Brian Lalli - *Barclays - Analyst*

Very quickly, if I may, maybe switching to the fixed income side. Just first on ratings, you maintain a slide in your investor presentation that you target IG rating. So I'd just be interested to hear some updated thoughts on this, given S&P's rating on your bonds and then also the negative outlook at Moody's. Is this something that, again, would you take actions to hold IG ratings if the commodities cycle remains challenged? And then I have one quick follow-up.

John Floren - *Methanex Corporation - President & CEO*

Sure. I'll ask Ian Cameron, our CFO, to answer that one.

Ian Cameron - *Methanex Corporation - SVP Finance & CFO*

Okay, Brian. As you know, Methanex has operated as a company very prudently over a number of years. We've set up the Company given the fact that we expect to see cycles that we're seeing right now. So we focus on strong liquidity, strong balance sheet, and good cost structure, all of which are in place. Today, as John mentioned earlier, prices are at a level where we recover all our fixed costs, debt service, and dividends. So we're in really good shape.

In terms of how the ratings agencies look at us, I think you'd have to talk to them. But what I would say is that rating agencies for the most part will give you some time to manage through a down cycle. And I think that's what we're seeing today.

Brian Lalli - *Barclays - Analyst*

Understood. Okay, that's helpful. And then, my one follow-up, I guess it's for both you, Ian, and John. You discussed your dividend earlier and your confidence in keeping it at these spot levels as you just mentioned a minute ago. But I guess I'd also note that at current levels your debt securities are actually yielding more than your equity. So I guess the question would be -- how do you think about allocating capital to things like debt buyback, particularly as you have more confidence in free cash flow as EBITDA improves and the capital spend comes down over the next few years? If we could get your thoughts on that? Thanks a lot.

John Floren - *Methanex Corporation - President & CEO*

Sure. So our capital allocation strategy hasn't changed. Three uses for excess cash: Grow the Company; dividends, which three pillars of that -- sustainable, meaningful, and growing; and then share buybacks. So right now we're maintaining the dividend. We didn't grow it this year. We think it's sustainable, as we've mentioned many times. And it's obviously a meaningful yield today at well over 3%.

So any excess cash today, I think we'd have an option to look at buying back debt, or share repurchases. Our preferences would be share repurchases at the current trading, around $400 a tonne for installed capacity. So that, you know (inaudible) costs doubled or more than double I'd have to build new. We still think that's a better use of cash than bonds.

But we look at this on a regular basis. And our capital allocation strategy has been well known. And we've been very, very consistent in executing it. So that will continue to be our strategy.

Brian Lalli - *Barclays - Analyst*

Great. I appreciate the color. Thanks.

Operator

Steve Hansen; Raymond James.

Steve Hansen - *Raymond James LLC - Analyst*

Just one quick follow-up if I may. Just curious about your thoughts on the regional spreads that have evolved here. Clearly seen a big tightening in the North American market relative to Asia of late, but still at a small discount. Curious what your thoughts as to whether we get back to par and/or back into a small premium environment here in the next 6 to 12 months, if you have any thoughts. Thanks.

John Floren - *Methanex Corporation - President & CEO*

Yes. As the Atlantic Basin now has gotten long on production because of the additional production in the United States, what we anticipate to happen, Steve, is more what we used to see three, four, five years ago where the Middle Eastern producers will become the swing producers. And they all look at netbacks and I think for them going to Asia versus going to Europe on a netback basis makes sense.

So I think the premiums that you're going to see in the Atlantic Basin are probably more like they were four or five years ago. I think when Atlantic Basin was short and China was the marginal producer, the freight and terminaling to get that product from China to North America or the Atlantic Basin was almost $100.

So I don't think we'll return to that, but the future's very hard to predict. I think with the way we see things structured today and what's coming on in the next few years, we would expect the Middle Eastern producer to be the swing and the basin premium to be the freight differential between going to Europe versus Asia.

Steve Hansen - *Raymond James LLC - Analyst*

Okay, very helpful. Thanks, guys.

Operator

Final question; Chris Shaw; Monness Crespi.

Chris Shaw - *Monness Crespi Hardt & Co. - Analyst*

Even though sanctions were lifted for Iran, have they actually increased production or is it still stable? I know they have the plant they're building, but have they actually started producing more ever since that point?

John Floren - *Methanex Corporation - President & CEO*

No, Chris. If you look even post-sanctions, pre-sanctions and over the last four or five years, the amount of production has been relatively the same, about 3.5 million tonnes. And they've had some mechanical issues as well as gas restrictions in their wintertime. The gas deliverability in Iran -- although they have a lot of gas, it's difficult to get it all delivered because of infrastructure issues, which will take a lot of money and some time to address.

And we don't have any particular window into Iran today because we're still prevented from going there. So we think over time it might get resolved, but it's going to take a lot of money and need to build out that infrastructure.

What we have seen change is maybe a bit more product coming into places like the Mediterranean on a spot basis and a little less going into Asia. But this is on the margin. I think customers, before they're going to sign contracts on a longer-term basis -- starting next year would be the earliest time they could do it -- probably want to see how the sanctions evolve and how the relations between Iran and the rest of the world evolve.

So we haven't really seen too much change as a result of the sanctions coming off.

Chris Shaw - *Monness Crespi Hardt & Co. - Analyst*

Okay, thanks. That's all I had.

Operator

Thank you. This concludes today's question-and-answer session.

John Floren - *Methanex Corporation - President & CEO*

Okay. Thank you.

So while Q2 was another challenging quarter for the methanol industry, I cannot stress enough how pleased I am with the strength of our asset portfolio. Our concerted effort and investments to improve the reliability at our plants is exhibiting excellent results And at the same time, our near-term growth prospects in Chile continue to develop.

We are committed to maintaining a solid financial position and we look forward to generating strong earnings and cash flow for our shareholders.

Thank you for your interest in our company.

Operator

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