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Methanex Corp. (MEOH)

Q1 2020 Earnings Call

CORPORATE PARTICIPANTS

Kim Campbell

Manager-Investor Relations, Methanex Corp.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Ian P. Cameron

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

OTHER PARTICIPANTS

Ben Isaacson

Analyst, Scotia Capital, Inc.

Steven Hansen

Analyst, Raymond James Ltd.

Jacob Bout

Analyst, CIBC World Markets, Inc.

Joel Jackson

Analyst, BMO Capital Markets Corp. (Canada)

Michael Leithead

Analyst, Barclays Capital, Inc.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Nelson Ng

Analyst, RBC Capital Markets

Jonas Oxgaard

Analyst, Sanford C. Bernstein & Co. LLC

Eric B. Petrie

Analyst, Citigroup Global Markets, Inc.

Matthew Blair

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

Laurence Alexander

Analyst, Jefferies LLC

Jason Crawshaw

Analyst, Polaris Capital Management LLC

John Roberts

Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Methanex Corporation Q1 2020 Earnings Call. I would now like to turn the conference call over to Ms. Kim Campbell. Please go ahead.

Kim Campbell

Manager-Investor Relations, Methanex Corp.

Good morning, everyone. Welcome to our first quarter 2020 results conference call. Our 2020 first quarter news release, Management's Discussion and Analysis, and financial statements can be accessed from the Reports tab of Investor Relations page on our website at methanex.com.

I would like to remind our listeners that our comments and answers to your questions today may contain forward-looking information. This information, by its nature, is subject to risks and uncertainties that may cause the stated outcome to differ materially from the actual outcome. Certain material factors or assumptions were applied in drawing the conclusion, or making the forecasts or projections which are included in the forward-looking information.

Please refer to our first quarter 2020 MD&A and to our 2019 Annual Report for more information.

I would also like to caution our listeners that any projections provided today regarding Methanex's future financial performance are effective as of today's date. It is our policy not to comment on, or update this guidance between quarters. For clarification, any references to revenue, EBITDA, cash flow or income made in today's remarks reflect our 63.1% economic – present economic interest in the Atlas facility and our 50% economic interest in the Egypt facility.

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

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

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Thank you, Kim. Good morning, everybody. I hope everyone is safe and staying healthy during this extraordinary time. This morning, I'd like to start with a few comments about the current situation. I will then comment briefly on our Q1 results, provide an overview of what we are seeing in the methanol markets today and discuss how we're managing our business to navigate this challenging environment.

Our number priority is the safety of our employees, contractors and communities where we work, and I am thankful that our team is safe and healthy today. We are fortunate that our manufacturing operations have been allowed to operate in all of our regions.

Our operations in global supply chain are running effectively and have not been significantly impacted by COVID-19. We are continuing to produce methanol with a limited number of team members on site and are managing the rest of our business to deliver secure and reliable supply to our customers mostly working remotely.

I wanted to acknowledge and thank our team members from all around the world who have demonstrated tremendous dedication and agility over the past weeks as we've faced multiple challenges from the COVID-19 pandemic and low oil price environment.

Now turning to the first quarter results. We recorded adjusted EBITDA of \$138 million and adjusted net income of \$8 million or \$0.10 per share in the first quarter of 2020. These results are similar to our fourth quarter of 2019, results of adjusted EBITDA of \$136 million and adjusted net income of \$10 million or \$0.13 per share. Our first quarter results reflect a higher average realized price, partially offset by lower sales volume of Methanex-produced methanol.

In addition, our fourth quarter 2019 results benefited from a \$25 million insurance recovery associated with the production outage experienced in Egypt in 2019. We recorded \$5 million of additional insurance proceeds in the first quarter of 2020.

In the first quarter, we saw global methanol demand declined by approximately 7% compared to the fourth quarter of 2019 due to the impacts from COVID-19 pandemic combined with a sharply lower oil price environment. Methanol demand into traditional chemical applications declined as manufacturing activity was severely curtailed starting in China in late January and later in other countries as a result of the COVID-19 pandemic. Methanol-to-olefin or MTO demand declined due to several planned and unplanned outages. Demand into other energy-related applications also declined due to government restrictions, which limited ground transportation and service industry operations.

Methanol industry supply declined in the first quarter due to various outages in North America, the Middle East, Southeast Asia, and particularly in China where government restrictions related to the operations of moving up people substantially disrupted domestic methanol production. Our overall production results in the first quarter were 117,000 tons lower than the fourth quarter of 2019 primarily due to the outages in New Zealand, Chile, and Egypt, which were partially offset by strong production in Geismar. In addition, as we previously announced, we idled our Titan plant in Trinidad in mid-March, which also reduced our first quarter production volume in our Chile IV plant as of April 1. Both plants were idled for an indefinite period in anticipation of lower methanol demand.

In Q1, we continue to progress our Geismar 1 debottlenecking project. However, this incremental production from our Geismar 1 facility will be delayed as we have moved to minimum staffing levels at our plant sites to ensure the safety of our team members.

Now, turning to what we're seeing in the methanol market midway through the second quarter. We expect to see a decline in methanol demand in the second quarter of 2020 compared to the first quarter. We are seeing a substantial reduction in manufacturing activity in North America, Europe and Latin America, combined with continued weakness in Asia Pacific outside of China where we're starting to see a slow recovery with our customers. This decline in manufacturing activity is impacting methanol demand into all traditional chemical applications with products going into automotive and construction markets being the most impacted.

We're also seeing government mandates restrict ground transportation and curtail fuel demand which reduces methanol demand into methyl tert-butyl ether or MTBE and biodiesel derivatives. We also expect demand into the MTO sector to decline in the second quarter as three facilities are undergoing maintenance activities. In addition,

a sharply lower oil price environment indirectly affects methanol prices as oil prices impact the price of products that methanol goes into including MTBE, dimethyl ether, biodiesel, olefins and olefins derivatives.

We estimate that the industry cost curve which continues to be set in China is approximately \$220 per ton, which is a decline as a result of a slight decline in coal prices. Current methanol spot prices in China are below this range. In previous methanol price cycles, when methanol prices fall below the marginal cost of production, high cost production shuts down and supply and demand rebalance.

To date, in addition to our own production cuts, we have seen some other production rationalization globally. We believe that more production cuts are required to balance the global methanol market. We recently posted our May North America price which decreased by 13% to \$313 per ton and our Asia Pacific price which decreased by 13% to \$225 per ton. Our European contract price is set quarterly and our second quarter posted price is €260 per ton.

At this stage, we don't believe it is possible to actually predict the full extent of the duration of COVID-19 and the low oil price environment. As a result, we are planning for a wide range of scenarios including situations where we see a deeper and more prolonged reduction in methanol demand and low prices while positioning ourselves to deliver long-term value for our shareholders as the global economy recovers.

We have taken several prudent steps to further strengthen our balance sheet and preserve liquidity through this uncertain economic environment. First, we have placed our Geismar 3 project on temporary care and maintenance and deferred approximately \$500 million in capital spending for up to 18 months. This proactive step will enable us to further strengthen our balance sheet while maintaining long-term value and financial flexibility. This action will also allow us to complete this highly advantaged product when market conditions improve.

Up to this point, the project had been significantly de-risked and execution was safe, on time and on budget. We continue to explore partnership arrangements for the Geismar 3 project and we plan to continue those discussions. However, in the current environment and with most companies focused on navigating the significant uncertainty in the global economy and with the project on temporary care and maintenance, we're not expecting these discussions to progress meaningfully until market conditions improve.

In addition to greater financial flexibility and preserve liquidity, we have reduced our 2020 maintenance capital spending by \$30 million, increased financial flexibility through our \$436 million draw on our credit facilities, reduced our quarterly dividend to \$0.0375 from \$0.36 per share which represents approximately \$100 million in annualized cash savings.

We're also working with our banking partners to obtain flexibility on certain financial covenants for an existing \$300 million committed revolving credit facility and an \$800 million non-revolving construction facility.

We have agreed on key parameters with our lead bank and are working with other members of the bank syndicate to finalize these changes to the credit facilities, which is expected in the second half of May.

We have a flexible cost structure as the price for approximately 60% of our natural gas supply, which is our most significant operating cost, is linked to methanol pricing. This means that our operating costs move down as methanol price is reduced, although there is a time lag of up to one quarter. Also, we expect to see lower logistics cost primarily through lower fuel prices for our methanol shipping fleet in a low oil price environment.

We have a strong liquidity position and ended the quarter with over \$800 million in cash on the balance sheet. We expect the – we only need to maintain a minimum cash balance of approximately \$150 million to run the business. We are focused on cash preservation in this challenging environment and continue to evaluate all capital and operating spending. We do not expect to undertake share buybacks in this environment as any excess cash will be used to further strength – strengthen our balance sheet.

Before I comment on the second quarter outlook and pause for questions, I'd like to highlight a couple of points regarding the resilience of our business. First, methanol is an essential ingredient that is used in countless industrial and consumer products, including building materials, foams, resins, plastics, paints, polyester in a variety of health and pharmaceutical products. In addition, methanol demand is continuing to grow as a clean burning and alternative economic fuel. These are essential products and we expect demand will recover after the pandemic as and be the case with prior global economic turndown – downturns.

Second, we have a low cost structure and our assets are positioned on the low to mid portion of the industry cost curve, which allows us to be competitive across a wide range of prices and economics scenarios and service as well in the current environment.

Third, we benefit from our integrated global capabilities with a network of production sites around the world and global supply chain which are a competitive advantage that enable us to deliver secure and reliable methanol supply to our customers around the world.

Now turning to our outlook for the second quarter. We expect the coming months will be challenging and we expect that the headwinds we face from COVID-19 pandemic and a sharply lower oil price environment will be significant in the second quarter. With lower methanol prices and lower production levels, as we've idled our Titan and Chile IV plants, we expect that adjusted EBITDA will be substantially lower in the second quarter compared to the first quarter.

As a reminder, in the declining methanol price environment, our margins tend to be lower than in a stable price environment due to the timing of methanol production and purchases versus the timing of sales. We continue to monitor the impact of COVID-19 pandemic and low oil price environment and regularly review our plans across a variety of scenarios in order to respond quickly as conditions change.

We are focused today on keeping our team safe, running our plants safely and reliably, delivering secure and reliable supply to our customers and protecting our balance sheet to navigate this unpredictable environment. With our strong equity position and the resilience of our business model, we are confident that we are well-prepared to weather this global pandemic and its impact on methanol demand.

I would now be happy to answer any questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question is from Ben Isaacson of Scotiabank. Please go ahead.

Ben Isaacson

Analyst, Scotia Capital, Inc.

Q

Thank you, and good morning. Good to be back on the call and glad to hear everyone's doing well. John, you said that demand was down 7% in Q1. What's your early read on how April has played out?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. It's down more, Ben. It's very difficult. It's changing daily. But if we saw a 7% reduction in Q1, I think you should expect a much greater reduction in demand in Q2. Certainly, when we look at our own demand, we're down significantly. We don't know what our competitors are doing. But when you freeze the global economy and all – a lot of manufacturing ceases, I think demand from ethanol is going to follow right behind.

Ben Isaacson

Analyst, Scotia Capital, Inc.

Q

Thanks. And just as a follow-up, I've noticed that the discount rate has been widening out over the last few quarters, 16%, 17%, 18%, how do you see that progressing in the normal cycle going forward? Is that going to kind of go back towards that 15%?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Our guidance is unchanged there. In a normal, whatever – we wish to see a stable environment which we haven't seen much of in the last few years, 15% is the right guiding – guide – guidance. But as we go rapidly down, that tends to widen as we've seen in the last quarters. But I can point to 2018 when prices went up quite quickly that it shrunk. So, I'm still comfortable with 15%. But in this environment, you should be planning for higher than 15% as prices have come down in Q2 again from Q1.

Ben Isaacson

Analyst, Scotia Capital, Inc.

Q

Thank you.

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

Steven Hansen

Analyst, Raymond James Ltd.

Q

Yes. Good morning, guys.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Hi.

Steven Hansen

Analyst, Raymond James Ltd.

Q

So three quickly. John, you guys have taken some pretty proactive and stern measures here thus far. I applaud you for that. I'm just trying to get a sense to whether we should expect any additional actions on the production front? Are there any other facilities that you would contemplate taking down to help balance out the market on your side or is that going to be left to others?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Well, the reason we took Titan and Chile IV down is because those were the only really two plants where we had total flexibility where we didn't have take or pay gas. All of our other sites, we have take or pay gas. We have some ability to reduce Geismar by about 30% where we're buying spot gas, but spot gas is under \$2. So, hopefully prices don't deteriorate to such a level that we would have to take that action but anything is possible in this environment.

I think we have some other opportunities as gas contracts expire here over the coming months but we're not anticipating today to take any additional production out, but we're looking to try and create as much flexibility in our supply chain as we can to allow us to prepare for any eventuality that we might see in the markets.

I think others in the industry need to take some supply out as well. There's a lot of material today that are well above from a cost delivered cash cost perspective where we're seeing pricing around the world. So, I don't think people like to lose cash. Certainly, we don't. So, hopefully we'll see some of the high cost producers that are still operating curtailed over the coming weeks and months.

Steven Hansen

Analyst, Raymond James Ltd.

Q

That's helpful. And just as a follow-up to that, is it fair to say that your discussions with the NGC in Trinidad are currently at a pause?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

No. We're still discussing with the NGC. All countries are really dealing with the COVID-19. So, whether it's our discussions on a gas contract or any other discussions with the government are taking a backseat as they deal with the pandemic, but we're still negotiating. We're negotiating in good faith. We'd like to secure a contract that makes sense for us, the government and the upstream and that's our intention. So, we're going to continue to work towards that.

Steven Hansen

Analyst, Raymond James Ltd.

Q

Very helpful, guys. That's it for me. Thanks.

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

Jacob Bout

Analyst, CIBC World Markets, Inc.

Q

Good morning.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Hey, Jacob.

A

Jacob Bout

Analyst, CIBC World Markets, Inc.

I want to review the total CapEx spend expectations. We're calculating around \$310 million in 2020, \$330 million in 2021. Is that the right order of magnitude and what type of wiggle room do you – would you have there?

Q

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Yes. So we've cut maintenance spending for this year by about \$30 million. We've reduced the G3 project by about \$500 million over the next 18 months. We said we're going to spend up to \$200 million over that period for G3. We're hoping or we're planning and challenging the team to spend less. And our maintenance capital is under review all of the time. I mean, we will reduce maintenance capital where it makes sense, where we're not putting our plants in a state where they're unsafe. So we're going to spend the money to keep our plants safe. And if there is opportunities to reduce maintenance capital that doesn't impact safety, then we'll look at it.

A

I'll remind you, most of our maintenance capital is to deal with turnarounds. Statutory turnarounds, turnarounds. We've delayed turnarounds because we couldn't execute them in this environment because we couldn't get people to where they need to be. So we're going to learn a lot around how much maintenance capital we can defer. We can't do a turnaround and we can't run the plant safely, then we'll shut it down. But right now, we're comfortable that the turnarounds we delay, we can run those plants safely and they're performing okay. So I don't want to give you definitive numbers, but we're going to look at each and every bucket including operational expenses to see what we can defer or cancel. So we'll continue to do that as we go forward and see how the markets turn out.

Jacob Bout

Analyst, CIBC World Markets, Inc.

And then, how much liquidity do you have available today and what type of covenant relief are you looking for?

Q

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Yes. So we have \$800 million in cash on our balance sheet at the end of the Q1. I have said, we need probably \$150 million to run the company. So that guidance is still there and maybe I'll ask our CFO, Ian Cameron to just comment about the covenants and the bank relief.

A

Ian P. Cameron

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

So Jacob, there's probably three things we're looking for in terms of flexibility. One is we have two covenants, interest coverage, EBITDA-to-interest test and we have a funded debt ratio which is like a leverage test. And today and we're in compliance with those covenants, but if we saw a sustained lower price environment, those covenants could come under pressure. So we're trying to get some short-term relief around – and flexibility around those two covenants. The other covenant that is around G3, we're just trying to create more flexibility in terms of completion – timing of the completion of G3. So that's the third area where we're trying to obtain some more flexibility.

A

Jacob Bout

Analyst, CIBC World Markets, Inc.

Thank you.

Q

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Thanks, Jacob.

A

Operator: Thank you. The following question is from Joel Jackson of BMO Capital Markets. Please go ahead.

Joel Jackson

Analyst, BMO Capital Markets Corp. (Canada)

Hi. Good morning, John.

Q

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Hey, Joel.

A

Joel Jackson

Analyst, BMO Capital Markets Corp. (Canada)

John, I like to ask you a question about whether or not you continue with G3. You are. But let's pretend that you have to decide that it didn't make sense because of demand in China or the global demand for methanol this decade that it didn't make sense to build G3. So I guess the question will be what penalties, what minimum spend would you have to still go out the door in winding down that project? Thanks.

Q

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Yes. It's too early to say – to give you a number there, Joel. I mean we're negotiating all the time with our partners on the G3 project. It's our intention to complete it at some time. If it comes to a point where it's just not needed or the world is still in a really serious significant downturn, then we'll do what we have to do to mitigate the costs around canceling that project. It's not our current view on the project, but everything is on the table. I would say that we've been issued a number of force measures and delays on equipment, etcetera, because of the COVID-19 which gives us some additional flexibility as we negotiate with our partners. So we want to have win-win situations here.

A

And we will continue to negotiate and try to find a solution that makes sense for everybody. But I think, it's a bit premature to be thinking about canceling. And I think it's when you make that decision where you are and what you've been negotiated which will drive how much additional capital you may have to spend. But we're trying to minimize that as we go forward.

Joel Jackson

Analyst, BMO Capital Markets Corp. (Canada)

And my second question would be on cost curve from methanol in China. You think you have to where you think it is and what's driving marginal costs today between thermal and gas? You're obviously seeing thermal coal prices

Q

get down to below and out the bands the government has set in and you think if intervention will come or not. So a lot of stuff going on there. Maybe talk a little on where you see the marginal cost from that being right now?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. 220 being set by coal producers. We've seen coal slightly decrease. It's around just over RMB 500, RMB 510 which is just at the lower end of the band that the government had put in after the last oil collapse in 2016. Something we're watching pretty closely and certainly, if it does go a lot lower, that will impact the cost curve. But here we are, China is been dealing with COVID since the end of January. So three months and the band seems to be alive. But that doesn't mean it's going to continue. So it's something we'll watch pretty closely.

Joel Jackson

Analyst, BMO Capital Markets Corp. (Canada)

Q

Thank you.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Thanks, Joel.

Operator: Thank you. The following question is from Michael Leithead from Barclays. Please go ahead.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

Thanks and good morning, John.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Hey, Mike.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

I want to return back to the conversation around your natural gas cost and obviously the variable cost dynamic where you tie your cost to methanol prices has been helpful throughout the cycle. But can you just maybe give us a little more help on how these contracts work now, they were at uniquely low part of the methanol price cycle. Is there any sort of variable cost floor where methanol goes further down that doesn't equate to lower realized natural gas cost?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. They are all a little different. So we don't obviously talk about each and every contract on an individual basis for commercial sensitivity reasons. What we have guided to in the guidance still is valid today is that above \$180 methanol realized price, we share about a third with the gas supplier on average through the contracts. So, today, we're over \$200 a ton realized. So, even if we saw a further reduction in realized methanol pricing before – once we get to \$180, on a realized basis, you should consider that, on average, the floor for the basket of gas contracts although someone have a little higher floor and someone have a little lower, but that's the guidance we've provided and that's still valid today.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

Got it. That's really helpful. And I appreciate the outlook is very foggy today, but just given what you've talked about the moves in price, the timing lag of inventory and cost flow through, and just I presumed increased overhead absorption from the lower volumes, would you still expect to be EBITDA positive in the second quarter?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

I think it's too early to say that, but if you ask me today, we will be; but things are moving pretty quickly here. We're only in early May. We've set May pricing. And I think, unless you saw a complete collapse in June, which I guess is possible, we will be EBITDA positive in Q2.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: Thank you. The following question is from Hassan Ahmed of Alembic Global. Please go ahead.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Good morning, John.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Hey, Hassan.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

John, a question around – it was very helpful hearing your views on ways or demand growth – or demand declines, rather, sequentially in Q1. Obviously 7% declines in Q1. And then you guys obviously idled some of your facilities. Just wanted to get a sense of the way you saw the industry sort of pan out in terms of supply in Q1. I mean did you see an equivalent sort of global supply decline in Q1 sort of matching the demand decline? Was it higher, was it lesser particularly keeping in mind the shutdown more in China in particular was in Q1 and where do you see that figure supply wise as we sit here today?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Most of the shutdowns we saw from a supply side were in China. You're right to point that out. Our actions were late in the quarter. So it really flow through into Q2. We haven't seen too much. We've seen some other shutdowns and as I mentioned in my remarks in other parts of the world. But we need to see based on our current demand look a lot more shutdowns and there's a lot of production today which is above the realized price that we're seeing around the world especially in China.

So we would anticipate as we've seen in previous downturns that supply will come off as the cash margins remain negative. It takes a while sometimes. It takes weeks and sometimes months. And then I think it's more predicated on what their outlook is for the next one or two quarters.

And I think that's really hard to anticipate in this environment. But when you turn off the global manufacturing complex, demand does get impacted and we've seen this move around the world. We saw in China first in January then in Asia in mid-quarter, first quarter. And now in Europe, North America, South America that production or sorry the manufacturing has been turned off. So, in order to balance things, we need to see other supply come off.

And the other issue is storage. There's not enough storage to manage all the methanol that's being produced today, and there'll become a point where there's just nowhere to put it and that'll force people to turn off no matter what their cost position is. So it'll be interesting to see how it develops over the next quarter or two.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Understood, understood, helpful. And as a follow-up, John, obviously, all sorts of stress within the oil and gas markets and the like, question around your contracts. I mean, if I remember correctly, back in 2013, you announced a 10-year contract for gas supply to Geismar with Chesapeake Energy. Obviously, that company – reading the news recently seems to be in fairly sort of deep stress and enough sort of reports out there about bankruptcy filings and the like.

So just wanted as best as you can, what sort of moves are you considering, what optionality do you have in case of a bankruptcy out there? I mean, is – in terms of security of gas supply, upholding of the contracts and the like?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. So I think that's a short-term and a medium-term issue. I mean, if we were to have the supplier of Geismar 1 go bankrupt, it'd be very positive for us because obviously the spot market today is much lower than what we're paying in Geismar. So when we signed these contracts in North America for Medicine Hat and Geismar, we had a view that if markets got really tough and people went bankrupt, we had natural hedge that meant that the gas price is very low. I'm not worried about the supply of gas in North America for the foreseeable future.

But I think the medium-term is a bit different. If you have a very low oil price environment and gas environment, then you're going to see production, budgets being slashed and exploration and development budgets being slashed.

So, places like New Zealand, Chile, Trinidad, I get more concerned around how do those assets become sustainable long-term because you know in this business of oil and gas if you're not investing, you have declines each and every year which could lead to not enough gas to go around at some point in the future. So, I worry more about that in short-term bankruptcies in North America.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Understood. Thank you so much, John.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Thanks.

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

Nelson Ng

Analyst, RBC Capital Markets

Q

Great. Thanks. My first question relates to the debt covenants and flexibility. I presume you guys drew on your credit facility because there's the potential at some point in the future that it may no longer be available. I'm just wondering if you were to get relief on debt covenants, whether you would look to use that cash to pay down the credit facilities so you don't have to pay the or incur the carrying cost that is sitting on cash?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

We don't know. I mean we're still on negotiations. So, everything is on the table. We're looking for relief on the covenants to give us more flexibility. I mean we didn't do anything on those lines of credits or credit facility that we weren't allowed to do.

So, we thought it was prudent with all the uncertainty to get a bit more cash on the balance sheet, which is what we did. But we're negotiating many, many different things related to those covenant relief. And when we have a deal, we'll certainly let the market know what that deal looks like including paying down debt with cash. So, it's too early to say anything about that. But once we have a deal, we'll certainly let the market know what it looks like.

Nelson Ng

Analyst, RBC Capital Markets

Q

Okay. And then my next question relates to methanol demand. You mentioned that obviously that the manufacturing sector is very weak, but you saw some signs of recovery in China. Could you give a bit more color on what you're seeing in China, I'm just thinking about whether there is a potential read through of things to come for the rest for the world, if – in terms of the recovery profile you're looking at in China?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. It's slow, I would say. We are seeing recovery, but it's slow. Looking to me like a U-shaped recovery instead of a V-shaped, but that's early days. I think we'll see how Europe comes out of the pandemic and certainly the United States is in the middle of it right now. So they're starting to open up. So we'll see how that pans out for cases etcetera.

But China is starting to unthaw and get back to more manufacturing activity, but it's still nowhere near what we saw in the fourth quarter of last year. And obviously China is a very – has a lot of exports and they rely on the rest of the world's economy to be chugging along to have somewhere to – to send their exports. And obviously in the current environment, everything is basically stopped.

Nelson Ng

Analyst, RBC Capital Markets

Q

Great. Thanks for that color. I'll leave it there.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Thank you.

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

Jonas Oxgaard

Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, thank you. I want to touch back a little bit on the comment earlier on storage is basically full. I just want to – what specifically happens when you run out of storage? The Chinese producer historically have been quite bad at turning off production, even at negative cash quickly.

And so, if we're running in this scenario where we're still producing methanol globally, there's no demand for it, is there a change we'd run in to the WTI of negative pricing, paying someone to turn into DME or what – have you ever seen anything like it? I know that was a bunch of questions that are tied into one, but have we seen anything like it and what's your thinking of where we're heading next?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

We obviously, haven't seen anything like it. I would disagree a little bit with what you said about production in China. In previous downturns in 2009 and 2016, we did see high cost production come off and we've seen that again this time. So they don't like to lose cash and they're probably quicker to move than some of our competitors in other parts of the world as far as turning off production. And we've seen them do that quite substantially over the last couple of months. But if there's no – when I talk about [indiscernible] (34:06) Chinese producers more. I'm talking about imported product in the different parts of the world.

There's limited storage capacity. This was already an issue before COVID-19 as demand has gone up significantly in China for things like MTO. The amount of storage that was built was not anywhere close to what we saw the increase in demand. So it was already an issue of supply chains and moving product in and out on a timely basis to meet demand with very little storage.

So once tanks fill up, I guess the next thing and similar to the oil companies as you can fill up ships. And I think some of that is going on. We've seen spot rates for ships go up quite significantly and we think that's because of storage. But once that's full, then you have to turn off production or else, dump it somewhere else. So I think it make sense to turn off production rather than have nowhere to put it. But certainly, we haven't seen that in the history of our market, but oil was not – never it's been negative before for a long time either. So I think we're in an unprecedented times in trying to predict anything in this environment is foolish.

Jonas Oxgaard

Analyst, Sanford C. Bernstein & Co. LLC

Q

Fair enough. And I'd say, if we have to actually do something else with it, is there a capacity to turn it into, say, DME or I mean this negative margin today to make DME for methanol? But if you have to do something with it, could you set fire to it?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Well, I guess you could set fire to it. And the easiest thing to do it would be to blend it in gasoline. But I think that's a whole more complicated issue. But besides that, I think you either set fire to it or dump it. But I think environmentally, I'm not sure that makes a lot of sense either. So to me the rationale thing to do is to turn off production.

Jonas Oxgaard

Analyst, Sanford C. Bernstein & Co. LLC

Q

Fair enough. Thank you.

Operator: Thank you. The following question is from Eric Petrie of Citi. Please go ahead.

Eric B. Petrie

Analyst, Citigroup Global Markets, Inc.

Q

Hi, John. Good morning.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Good morning.

Eric B. Petrie

Analyst, Citigroup Global Markets, Inc.

Q

What is your exposure to MTO compared to the industry? And how does the methanol demand fair into MTO given [indiscernible] (36:14) economics have turned more advantage? And are those customers advancing or extending turnaround times?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. So our MTO exposure is less than many of our competitors. We have a couple of customers where we're selling MTO. I'd say the MTO rates have held up quite nicely even in a very low environment for naphtha and a very low environment for olefins. I mean ethylene, I think, is at historical low prices. So that's – today that doesn't mean that's going to be the case tomorrow. But we've seen MTO demand hold up quite nicely. And again we'll continue to monitor it. But we've seen some plant turnarounds and these turnarounds were planned in Q4 before the whole COVID-19 shock. So are they being extended because of economics?

We don't have that kind of intel. But we're seeing the operating rates in the 70% today in that market which is quite healthy. So we'll see how these current turnarounds pan out and what the operating rates look like when they return. But again, making a forecast in this environment is foolish, and we'll have to monitor things as they happen, not try to predict things that are unpredictable.

Eric B. Petrie

Analyst, Citigroup Global Markets, Inc.

Q

Helpful. And as a follow-up, you know that there were two projects that were expected to start up in 2020, obviously visibility into that as well. But in past down cycles like in 2008/2009, typically how long did you see project delays? And I – as a follow-up, what kind of methanol price do you need to see to restart construction of G3?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. So, there are two projects that are we thought would be completed in 2020; one was the Trinidad project and another one in the United States. We expect those to be delayed in the current environment. How delayed? It's a guess again. I'm not going to guess today. So, we expect those to be completed at some time over the coming few quarters.

As far as our starting G3, I mean, again, it's way too early. We're in the midst here of a significant downturn for methanol supply. We've negotiated a way to restart it over the next 18 months if things improve. And obviously what we'll need to see is a much better pricing outlook for methanol than we see today. And that seems to me a long way away from where we are today.

So, we're -we continue to see pricing go down and bottom out, below \$200; and we've always said we think the long term price of methanol is \$350. So, we're a heck a long way away from that price today; and I have no idea how long it's going to take for demand to return and to get back to any semblance of levels that we saw in the fourth quarter of last year; and I don't think anybody knows. So, we'll see as the economy start to open up the impact on further cases of COVID and how governments react. So, it's kind of out of our hands is what I will say.

Eric B. Petrie

Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

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

Matthew Blair

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

Q

Hey. Good morning, everyone. Glad to hear you're safe and sound. I want to clarify on the shipping cost for methanol. Previously, there are some concerns there to move higher. Now, have they moved lower due to cheaper fuel or would you say they're still pretty elevated due to storage demand and do you have any numbers on this? That'd be much appreciated.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. So, we're using methanol and ultra-low sulfur diesel in our ships, so you know what's happened to those prices. So when we entered the quarter, we expected them to be trading at a price that was relative to the oil price at that time. So, you can then see that those prices have substantially lowered which has led to lower logistics costs for us rather than higher which is what we're predicting. I wish they were higher because that means we'd have a higher oil and methanol price, but they're lower and that's what we're dealing with. So, I don't have the specific pricing in front of me, Matthew. We certainly can follow-up offline and get to that data.

Matthew Blair

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

Q

Great. Thanks. And then I want to circle back to some previous comments. So, John, you mentioned your hope that the higher cost methanol producers would cut back. You also noted that Methanex has some take-or-pay contracts on gas supply. Are these take-or-pay contracts pretty standard in the industry and something that could limit run cuts and plant shutdowns going forward?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Hope is not a strategy, so I didn't think I used the word, hope. Hopefully, I didn't. I think a lot of companies do have somewhat of take-or-pay contracts. But I'll remind you, a lot of these methanol producers, our competitors are state-owned or companies that are in geographies where they're kind of buying gas from state-owned company or national companies.

So, we're talking to our suppliers about our take-or-pay obligations and we have some flexibility. And I would say our competitors also have some flexibility. So, I think in this kind of environment, everything is up for negotiation. If you can't sell it and you can't store it, then you can't produce it. So, I'm not in preview to our competitors' conversations but I know we're talking to our suppliers about some flexibility in these unprecedented times.

Matthew Blair

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

Q

Very helpful. Thanks.

Operator: Thank you. The following question is from Laurence Alexander of Jefferies. Please go ahead.

Laurence Alexander

Analyst, Jefferies LLC

Q

Good morning. On the storage question, could you flip around and maybe give a thought or two on what this means for inventory levels in the chain relative to normal that is if -even if demand picks up, I mean how long it might take to work down some of that excess that might be sort of stored in ships with another unusual areas.

And secondly, could you give a quick update on some of the non-traditional applications, the M100 taxi trials, the industrial boilers, how demand levels are on that side?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. So, again, I can't predict the future. Demand will be the driver to how quickly we work through the overhang in inventories. We took – we are very quick proactive measures to take production out of our system to allow us maximum flexibility in our inventory and I'm glad we did that although it was criticized at the time because they give us a lot of flexibility, we have a lot of flexibility in our current supply chain to weather significant demand downside and we're looking at creating more flexibility.

So, again, if you can tell me what your outlook for demand for methanol is, I can tell you how long it will take to work through excess inventory and I don't think either of us knows that. So, I'll move to your second question which is around the kilns, boilers, and M100. Well, obviously, M100 taxi trials continue. But if nobody is driving anywhere or going anywhere then fuel is not being consumed. I know myself. I don't think I filled up my car here in the last eight weeks. So if that's any indication of the fuel consumption around the world, then we're going to continue to see things like MTBE and biodiesel and M100 be under pressure from a demand perspective.

Fortunately, kilns and boilers is different. Those are needed for heating and creating electricity and mainly heat, sorry, for blocks of buildings in China. So we continue to see nice growth there. But when you look at the demand, the structure we've seen elsewhere, it's just a drop in the bucket compared to what we've seen on the demand destruction side.

Laurence Alexander

Analyst, Jefferies LLC

Q

Just on the – maybe another way on – to think about the inventory question is just is it significant as a build or is it once – if we had any kind of recovery even to say to demand levels that we saw a month ago, would it just be serving a blip?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Again, I don't know how much is out there is being stored on ships. It's anecdotal. But we have seen the spot rates for ships. Chemical tankers go up quite significantly. We have heard anecdotally that people are storing methanol on ships. We know they had storage in tanks. And the average storage was, let's say, 800,000 tons on the coast in China, maybe it's 1 million plus today. So it wouldn't take too long to move through that in a better demand environment. But the big question I don't know is how much is being stored on ships.

Laurence Alexander

Analyst, Jefferies LLC

Q

Perfect. Thank you.

Operator: Thank you. The following question is from Jason Crawshaw of Polaris Capital Management. Please go ahead.

Jason Crawshaw

Analyst, Polaris Capital Management LLC

Q

Hey, John. Just a couple of questions here. In terms of what you think needs in terms of supply side of the market, I guess, on a percentage basis, I mean, how much supply do you think needs to come out to get the market balanced? That'd be the first question.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

It depends on where the demand ends up, Jason. So, it's really early to tell. Is it going to be 20%, 30%, 40%? I don't know. And how long? I think that's the other issue. So, this market is – has always been balanced. It's just a meaning at what price. And at the current spot prices in China, there's probably 50 million tons underwater on a cash basis, so out of 80-million-ton market. So, a lot needs to come out if you have a significant demand destruction. But I can't predict what that demand destruction could look like over the coming quarters.

Jason Crawshaw

Analyst, Polaris Capital Management LLC

Q

Got it. But it sounds like it's not 10%. It sounds like 20%, 30%, I mean, a meaningful...

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. It's not 10%. Yes, it's not 10%.

Jason Crawshaw

Analyst, Polaris Capital Management LLC

Q

Okay, got it, got it. And then, I guess, the other question is in terms of when supply comes out and then to see your plants being idle. Once the plant is idle, how difficult it is to restart? I mean, they're big timing costs and there are costs of – you see it was fairly flexible?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes, pretty flexible. We've kept all of our people. People cost for us is a – is not a very significant cost. We only have 1,500 people in the whole organization. They're very skilled and technical, and we need them to restart these plants. When we take them down, we take them down in such a way that we preserve them very well. So, if we made the call tomorrow that we're going to start these plants up, you're talking weeks, not months.

So, we're – our plan is to keep our teams in place and to be ready to restart when the conditions are right. But I can't see that happening in a – in the immediate future. So, we'll be ready, and I hope I'm wrong that things will improve a lot quicker than I'm anticipating but I really don't know, but we will continue to keep those plants ready to restart and our people in place to be able to run those plants if and when the time is right.

Jason Crawshaw

Analyst, Polaris Capital Management LLC

Q

So, it sounds like an idling restart to yourself or others in the industry. I mean it's not sole owners in terms of basically costs and some of timing duration that people can't be flexible about bringing the supply out of the market and bringing it back on in terms of if demand recovers.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. That's what I would suggest. That's how it's happened in the past in 2009 and 2016 when we had similar conditions. Those times though it only lasted a quarter or two and we didn't – those were one with an oil price shock which took a lot of demand out permanently and the other one was the financial crisis which froze liquidity for a quarter or two. But this seems to be quite different to me. This is not what one of those events. This is once in a 100-year event and we're learning as we go and I'll refuse to predict what is going to happen next week, never mind next month. So, we're going to manage the best we can in a really difficult environment.

Jason Crawshaw

Analyst, Polaris Capital Management LLC

Q

Thanks guys.

Operator: Thank you. [Operator Instructions] The last question is from John Roberts of UBS. Please go ahead.

John Roberts

Analyst, UBS Securities LLC

Q

Thanks. Glad you sound well. And sorry, you have to deal with these challenges here. John, would you has to guess at which end market might come back the first? Do you think fuels applications because driving – it looks like it's already starting to come back or something like formaldehyde in the construction market might come back as that's usually stimulated during when interest rates drop and the government start doing things?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Yes. Again, predicting the future is really hard in this environment, John, but I would expect the automobile driving to pick up pretty quickly. I'm not sure if people are going to be comfortable taking transit as an example. So are we going to see a whole bunch of new cars being bought and driven? It could be. I think people have been at home now for quite some time and maybe construction activity will pick up as people renovate. And I'm on the board of West Fraser which is the largest lumber producer in North America and we've seen a lot of activity in rentals for homes market for – even in the current environment as people have stayed at home. So I think that's another industry that could pick up pretty quickly.

But to me, it's all around economic activity and economic activity is created by people doing stuff, by feeling free to move around and do their normal day-to-day activities before COVID-19. I personally think there's a lot of fear out there still. And even if things do open up, that'd be a very slow pace of getting back to whatever the new normal is. So that's my personal opinion, but that's just a guess. But I think there are certain applications like you mentioned which could bounce back quicker than others.

John Roberts

Analyst, UBS Securities LLC

Q

And then in Trinidad, I assume you'll have no problem getting gas when you restart. But I think Chile has been a little bit more competitive on gas. If you're down for an extended period, do you think longer term that might hurt your ability to negotiate gas there with the country?

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

No. I think I'm more concerned about further production exploration. Most of the gas we get for the second plant, all of the gas we get for the second plant comes from Argentina. That gas, if we wanted to start up tomorrow, is there. But what happens to Argentina and its situation in this environment and how does the E&P companies in the south there continue to develop gas reserves, so those are unknowns to me.

But today, there's lots of gas in that cone. But five years from now, who knows. I mean, it depends on how all of this pans out and where we go from here. So a bit of a guess, John. Again, I don't know what's going to happen next week, never mind a few years from now.

John Roberts

Analyst, UBS Securities LLC

Q

Okay. Thanks. Stay safe.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

A

Thanks, John. You too.

John Floren

President, Chief Executive Officer & Director, Methanex Corp.

Okay. Well thank you. I wanted to reiterate that our top priority is keeping our team members safe and healthy. We will continue to operate our plants safely and reliably, deliver secure and reliable supply to our customers and protect our balance sheet. We have a strong financial position and we believe that we're well-positioned to weather the methanol demand destruction and other challenges resulting from COVID-19.

Thanks for joining us today. Stay safe and look forward to connecting with you in July. Thank you for the interest in our company.

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

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