

Under the Hood: Methanex might be priced for perfection right now.

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Today we're going to try something a little different. If successful it could become a recurring feature here at InvestorIntel, and if it falls flat on its face then it will never be heard from again. We're calling it "Under the Hood" and the intention is to dig a little deeper into a Company, or perhaps a trading theme, or a trend that either doesn't make a lot of sense to me (as is the case today) or perhaps has a lot of room to run from where it is currently trading. It's simply my observations on a topic that is derived from spending far too much time watching the business news channels every day. Keep in mind, I am not a licensed investment advisor and may not extend buy or sell recommendations. Correspondingly, this should not be construed as investment advice, simple the ramblings of a curious investor. Disclaimer aside, let's get on with the show.

Despite yesterday's sell off, along with virtually everything energy related, I've been perplexed by how [Methanex Corp.](#) (TSX: MX | NASDAQ: MEOH) recently hit multi-year highs in an environment of super high natural gas prices. Why, you ask? As the world's largest producer and supplier of methanol to major international markets in North America, Asia Pacific, Europe and South America, their primary feedstock (or input cost) is natural gas. A quote directly from the Methanex website states – "On an industrial scale, methanol is predominantly produced from natural gas by reforming the gas with steam and then converting and distilling the resulting synthesized gas mixture to create pure methanol." Which made me wonder what the market sees that I

don't, or is it the market that is missing something?

My first thought was that maybe methanol prices were inelastic and Methanex could flow through all operating cost increases as long as demand was there. This doesn't seem to be the case as witnessed in Q3/2019 when pricing for methanol was poor and the Company couldn't cover operating costs and posted both an operating loss and a net loss for the quarter. Q4/19 would also have been a loss except for a one-time insurance recovery. Moving on to 2020, three of the four quarters also resulted in weak methanol sales pricing and net losses. Without digging a lot deeper into each and every quarterly report, this signals to me that Methanex isn't able to dictate the sales price to end users.

Next, I thought, perhaps they have some great hedges in place such that, at least for the time being, they would make out like bandits with a low input cost and continually rising sales prices. This is getting closer to the heart of their current success. Several Methanex natural gas supply contracts include a base price plus a variable price component linked to methanol prices. It appears that there is a floor to the prices they have to pay for feedstock which is what hurt them in 2019 and 2020 but when natural gas prices are ripping, like they did in late 2021 and again recently, they are far less likely to get caught in a supply crunch and have to pay spot pricing for their feedstock.

It's all good, Methanex should be a great investment in a rising price environment, case closed. Or maybe not. After digging a little deeper through their financials, I found this gem under Cash Costs: "We apply the first-in, first-out method of accounting for inventories and it generally takes between 30 and 60 days to sell the methanol we produce or purchase. Accordingly, the changes in Adjusted EBITDA as a result of

changes in Methanex-produced and purchased methanol costs primarily depend on changes in methanol pricing and the timing of inventory flows. In a rising price environment, our margins at a given price are higher than in a stable price environment as a result of timing of methanol purchases and production versus sales. Generally, the opposite applies when methanol prices are decreasing.”

Based on this, it appears they could be setting up to have a disappointing quarter in the future, albeit still profitable. I doubt it's Q1/22, given the price of everything commodity related is rising due to the fallout from Putin's insanity in Ukraine. However, if cooler heads prevail, hopefully, sooner than later, Q2/22 could prove to be somewhat disappointing to Methanex investors when natural gas prices either stop going up or even turn around and start to fall and this cash cost lag takes a bite out of EBITDA and Net Profit.

Another potential tailwind that becomes a headwind is that Methanex doesn't suffer from supply chain issues as they own the world's largest methanol ocean tanker fleet. This helped make them the supplier of choice for the methanol market when the rest of the world was watching boats get stuck in the Suez Canal. With that said, we all know that there aren't any EBs out there right now so transportation costs will be rising quickly and sharply. This could turn the tide, so to speak, on something investors have been giving Methanex a market premium for when the world was fraught with supply chain issues but becomes a proverbial boat anchor as increased shipping costs hit hard.

Lastly, and this isn't just Methanex but every commodity producer, is demand destruction. I definitely don't know enough about [methanol uses](#) but like everything, at some price consumers will try and find a cheaper alternative or go without if they can't, in turn, pass along the increased costs to the ultimate

consumer. Approximately 45% of global methanol demand is in the energy sector including direct gasoline blending, marine shipping fuel, and biodiesel. We've seen historically the impact an oil price of \$130/bbl can have on demand, so I think one has to be overly optimistic to think methanol sales volumes will be unimpacted by rapidly rising prices. Albeit, demand destruction takes time, but I think this also potentially lines up for the Q2/22 results.

So, what does it all mean? I feel like Methanex might be priced for perfection right now. This latest quarterly earnings season saw some of the biggest moves I've seen in my life on disappointing results and/or forward guidance. If a stock isn't absolutely perfect every quarter, it can get a big haircut in very short order. Keep that in mind if you are long or thinking about going long Methanex.