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Celanese Corp. (CE)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the Celanese Q3 2021 Earnings Call and Webcast. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It's now my pleasure to turn the call over to Brandon Ayache, Vice President, Investor Relations. Please go ahead.

Brandon Ayache

Vice President-Investor Relations, Celanese Corp.

Thank you, Kevin. Welcome to the Celanese Corporation third quarter 2021 earnings conference call. My name is Brandon Ayache, Vice President of Investor Relations. With me today on the call are Lori Ryerkerk, Chairman of the Board and Chief Executive Officer; and Scott Richardson, Chief Financial Officer.

Celanese Corporation distributed its third quarter earnings release via Business Wire and posted prepared comments about the quarter on our Investor Relations website yesterday afternoon. As a reminder, we will discuss non-GAAP financial measures today. You can find definitions of these measures as well as reconciliations to the comparable GAAP measures on our website.

Today's presentation will also include forward-looking statements. Please review the cautionary language regarding forward-looking statements, which can be found at the end of the press release as well as prepared comments. Form 8-K reports containing all of these materials have also been submitted to the SEC.

Because we've published our prepared comments yesterday, we'll go ahead and open the line for your questions.

Kevin, please go ahead and please open the line.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Vincent Andrews from Morgan Stanley. Your line is now live.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you and good morning, everyone. Just in Engineered Materials, you only had a modest volume hit sequentially despite obviously the auto situation got more challenging in the quarter. And you found other high-value places to put that volume. So, I guess, as we think about 2022 and 2023 and that auto volume comes back, presumably, you're not going to – I guess, my question is, is that incremental on top of where you've already put this other volume? Or do you anticipate having to shift some of that volume back to your auto customers?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Thanks for the question, Vincent. If we look at Q3, auto builds were down pretty significantly globally, like 12% down from the prior quarter. And certainly, that had some impact on us. What I would say is though it had less impact on us just given the nature of where we are. I mean, if we really look at our Q3 volumes, they were down into auto only about 1%.

And there's a couple of reasons for that. One is if you look at – we have shifted our portfolio more to electric vehicles. Electric vehicles are actually up about 35% year-on-year in terms of builds, and we expect that to continue into next year. And because we have so much more exposure now to electric vehicles, so think about lithium-ion battery's separator film, which has grown 40% year-on-year.

Even though only about 10% to 15% of our portfolio now goes to electric vehicles, that's still went a long way in kind of negating the impact we saw from the overall decline in auto builds. So, what I would say is, yes, while we did shift some volume out of auto, we also have the shift within auto which allowed us to really get through the quarter with very little volume loss end-to-end markets. And we did see some more shift into other applications like industrial and electrical which were strong during the quarter. But I'd say actually more of the shift was probably within auto into the EV, which is consistent with the strategy that we laid at the end of 2019.

Scott A. Richardson
Executive Vice President & Chief Financial Officer, Celanese Corp.

A

Yeah. We wouldn't expect to give that volume up as auto recovers in 2022 and 2023. So think about the auto recovery kind of being on top of that.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. And then if you think about where that volume is going to come from, because we did run pretty full in Q3, but we did lose about 8 kt of production in Q3 due to the unavailability of raw materials, be that resin or glass fiber, or flame retardants. So as those issues resolve themselves, hopefully through the end of the year and into next year, that's the additional volume that we'll be able to put into both auto and our other end-use applications.

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Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Great. And then if I could just ask on the $100 million, $50 million in EM and $50 million in AC, how does that trend – in your sort of 2022 and 2023 assumptions, are you assuming that sort of normalizes and you get it back or are you just sort of assuming it stays the same?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. I think just as we assume product prices and EBIT margins are going to normalize as we move through 2022, so probably towards the – in the second half of 2022 and we're assuming normalized prices in 2023, we also assume that those inflationary pressures in energy and in raw materials will also normalize in that time. So think about it as margins normalizing through the second half of 2022 and being normalized for 2023.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Makes sense. Thank you very much.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah.

Operator: Thank you. Our next question today is coming from John Roberts from UBS. Your line is now live.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. Do you or your syn gas supplier in the engine need to make structural changes to avoid the energy curtailments in the future?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, I mean, I think it's an interesting question. I mean, it's hard to know what structural changes you would make simply because the entire economy of China is based on coal gasification.

So, we don't really know what to expect in terms of energy curtailments in the future. What I would say is, look, we have seen this happen in China from time to time as a result of their Blue Sky initiatives, whether it's for the Olympics or some other thing. And so, we're not going to speculate on what's driving this energy curtailment. But while we expect the curtailments to be moderate in the fourth quarter, we don't really know what to expect yet for next year. So I think it's a little early to address this.

What I would say is, we are a little different than some of our competition in China, just in terms of what else our syn gas provider does. So, they have some choices that they can make about where the syn gas go, whether it comes to us or whether it goes into olefins. And frankly, right now economically, it makes more sense for it to come to us.

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John Roberts
Analyst, UBS Securities LLC

Q

And then back on the engineered plastics question. It takes a while to get spec'd into new applications, so I assume that rapid pivot to make up the lost auto volume that was existing applications that you've had that just surged?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, we're seeing strong demand across all sectors of Engineered Materials. So I would say, any volume we can make, we can sell to an existing customer for an existing application. That said, in the Q3, we had 815 project wins. We continued to grow quarter-on-quarter in terms of the number of projects wins we have. And the value of those project wins in Q3 was up 11% versus the prior year.

So, we are getting new projects all the time. They tend to be higher margin projects that we're able to close and they're higher volume projects. So, if you look at that going forward, as just said, our ability to shift between areas as we're essentially in a solid position will continue to be where we can continue to shift volumes into high-margin products.

Scott A. Richardson
Executive Vice President & Chief Financial Officer, Celanese Corp.

A

Yeah. John, if you recall a couple of years ago when Lori came in, one of the first things we did was do a robust strategy refresh. And what came out of that was the high-growth program focus that Tom Kelly and the Engineered Materials team talked about at our Investor Day. And so, a lot of that effort around 5G electric vehicles, medical, et cetera, was started two years ago, and we're really starting to see the pipeline pay off from that here now a couple of years into that work.

And so, I would say there's always some short-term stuff, but a lot of this is things we've now been working for a couple of years.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you.

Operator: Thank you. Our next question is coming from Jeff Zekauskas from JPMorgan. Your line is now live.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Our average acetic acid prices in China and Europe and average VAM prices in China and Europe likely to be higher in the fourth quarter than they were in the third or comparable?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. You have a great question, Jeff. We hope we can answer that. As we look towards the fourth quarter for pricing, I think we did see Q3 moderate from Q2 – I mean, down about 15% in China. Similarly though, we saw Western Hemisphere prices for acetic acid go up 15%. So I think right now, after the brief surge we had in prices following the energy curtailment, acetic acid has settled in now to kind of about $1,000 per ton price, so that's a

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little above Q3. But I do expect it's going to continue to moderate over the quarter. So, I guess, on average, our best view at this point is probably Q4 will look similar to Q3 in terms of averages for acetic acid.

I think VAM is a little trickier. We have seen a surge in VAM pricing following the energy curtailment as not just our VAM capacity which was shut down for a few weeks, but others' VAM capacity was shut down because these are more highly energy intensive processes in the Acetyl Chain. So, we have seen more loss of VAM capacity in China. With the higher raw materials, we've seen some of that capacity slow to come back or additional capacity stay down.

So VAM prices remain quite high, I mean, record levels, well over $2,000 per ton.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

And I think we're not seeing any falloff in demand for VAM and for downstream VAM derivatives just because there are such low inventories as you may be hearing from others on their calls in the chain. So, I would expect VAM pricing to – it's quite high in Q3, but I would expect that to stay at that level or possibly even a little stronger as we go into Q4, which would offset any further softening we see in acetic acid.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

So, there have been all kinds of outages in 2021 from weather, and then we had outages in China or curtailments in China. Have all of these different events led you to have a different view of where acetic acid and VAM pricing might be at the end of next year? That is, have they structurally changed the way that you expect the industry to evolve? And then secondly, with all of the outages that you've had this year, how much more acetyl volume can you produce next year than you produce this year at a normal operating rate?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. So have the outages affected my view of the industry, I think the answer is no. What continues to change is the supply/demand balance gets tighter and tighter, and we've been calling that out for a few years. I mean...

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

...every year, demand goes up 600 kt. And so that's like one plant every year and nobody's been building plants. So we're steadily now in that structural utilization kind of mid-80s to 90s, which means instantaneous utilization when you account for turnarounds and unplanned downtimes and everything is in that high-90s, mid-90s to 100%.

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Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

And that's going to continue. So it is that structural change in the industry which affects where, I think, we'll settle. I don't think we're going to settle acetic acid prices down in the $300 range where we used to see it settle. I think it is going to be higher than that because structurally it's just a much tighter industry. And I think what you see is the outages really reinforce that point because we very rapidly see the run up in pricing any time there's the slightest bubble.

So, I think it's not the outages that have changed my view. It's – I think the outages have reinforced our view that structurally this is a tightening market that is going into enjoy good margins for some period of time. And we've talked about it other quarters as there's not – we had a little bit of capacity come on in China this year with [indiscernible] (00:13:51). We have our capacity coming on in 2023, which of course, we will run to meet the market demand. It have a lot of flexibility to take it up and down depending on what's going on with the market. But there's nothing else currently being built. And yet, demand is going to continue to grow. So it is going to settle higher, but I think it's really the overlying structure versus, say, the outages.

So, what does that mean in terms of availability? I mean, yes, we were down this year for the freeze event and of course, we had some supplier issues for some time following the freeze event. Other than that, actually, our units run very reliably this year. I do think, as we move into future years, we will be back in a normal pattern of turnarounds. So while I think there's some incremental capacity available to us next year, I wouldn't say, it's probably really significant from a volume standpoint.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Okay, great. Thank you so much, Lori.

Operator: Thank you. Our next question is coming from Duffy Fischer from Barclays. Your line is now live.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Yes. Good morning. Maybe a little bit to follow on the last question and also tying into several of your big customers on the coatings side have actually called out emulsions is being problematic from a pricing and sourcing standpoint. So when you look at how tight you see things over the next couple of years, when you look at the size of those customers, should we expect some meaningful sized new announcements over the next year, either on VAM, where you would maybe ship in acetic acid? Or would there be anybody that would look at doing kind of an integrated acetic acid in the VAM project in the US?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

It's an interesting question, Duffy. I mean, let me kind of take the last part. I really wouldn't expect anybody to do an acetic acid to VAM to VAE kind of new build, I just don't think economically. I mean, that probably, just the

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acetic acid part of that is probably at least a $2 billion investment. And then, you add on the VAM and VAE, might even double that depending on the size of the facility.

So I think that's a pretty big lift for just about anybody, not to mention the space, the infrastructure, the permitting and everything. This is five- to seven-year prospect, if someone were to start now. So that's a ways out there. So I'm not worried about that.

Like I said, we have 1.3 million tons coming on in 2023, which is basically the equivalent of two world scale plants for acetic acid. And you'll recall, we've announced a series of VAM and VAE expansions globally around the world trying to meet what we do see as continuing strong demand.

I mean, part of the problem right now, of course, is with the freeze, with other outages, things have gotten behind. At one point, as people restock, the world will normalize again. As you'll see acetic acid prices come down, that will lead eventually to lower VAM prices and lower VAE prices. Energy is a big factor.

So, I mean, I think it's going to normalize even short of a lot of new capacity being added. But we do see the need for more capacity to come online, which is a need we think we're best positioned to meet, given our great technology, our energy efficient technology and our integration, not just within our plants, but also our networks globally that allow us to really optimize and provide secure supply to our customers around the globe.

Duffy Fischer
Analyst, Barclays Capital, Inc.
Q

Great. Thank you. And then maybe just a second one on the $15 for next year, can you walk us through are there any meaningful changes that would be in that number, cash flow that would get spent on a buyback? Maybe a change in the tax rate? I'm just trying to understand kind of like what's the base assumptions for that $15 for next year other than where spreads go.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Yeah. Let me just kind of walk through it and come with some of the things we're assuming in that number. So, what we said is, an adjusted EPS next year of at least $15. That is based on a belief our Acetyl business will have an EBIT between $1.2 billion and $1.4 billion. As I said a little earlier in the call, that assumes with the relatively strong pricing we're expecting in the fourth quarter continuing into the first half of the year, where you are in that range indicates where the different places we think it might start to moderate, whether it's a little bit before the third quarter, whether it's end of the third quarter.

We do though expect to see moderation to normalize pricing sometime midyear. And as I said, similar volumes to what we did this year because we think with turnarounds, normalized levels of turnarounds and everything, I just assume kind of similar volumes.

For EM, we are expecting $700 million to $800 million of EBIT. That does include Santoprene. It does include the organic growth both from our project model and our growth model, but also the Bishop GUR expansion.

But I would say it's also dampened a bit by our expectation that auto builds will not recover next year. So we're expecting auto builds at the same level we're seeing the auto builds in 2021 and that affects our normal materials into auto. And – but – it also will affect Santoprene because it is 65% into auto.

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And then in Tow, we expect it to be pretty consistent with this year because we expect it to continue to be challenged by acetic acid pricing at least in the first half of the year and also by energy pricing. I won't say if you add all those up, you might come up with a number slightly over $15.

So, what you should be aware of is, is we do expect the BU other to go up as we expect less pension income next year with maybe a softening in the market, which will then raise our BU other.

So, if you look at that in terms of free cash flow, I mean, free cash flow, we're basically seeing even with a lower expectation on EBIT earnings driven primarily by moderation in Acetyl, we do expect about the same level of free cash flow. So, lower earnings, but we do would then get that working capital normalization that shows up as free cash flow on our books if we see the moderation in Acetyl.

And we do expect slightly higher CapEx. We're still thinking CapEx around $600 million next year. But we won't have the EU payment. So, kind of look at all that, that washes out to basically free cash flow in the same level we expect to see this year.

Duffy Fischer
Analyst, Barclays Capital, Inc.
Q

Great and thank you.

Operator: Thank you. Our next question is coming from Hassan Ahmed from Alembic Global. Your line is now live.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Morning, Lori.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Good morning.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Lori, as I take a look at your sort of prepared remarks and the guidance you gave for the Acetyl Chain, looking for sustainably sort of over $1 billion in 2022 and 2023 EBIT. You cited, rightly so, a bunch of different reasons why you feel that's doable. One of them was the sort of uplift in the cost cuts. So just wanted to sort of get your thoughts around what's going on over there? Obviously, I see what's happening with the raw materials side of things and the like, and you cited sort of escalation in pricing for catalysts and the like as well. So just on a relative basis, I'm trying to get a better sense of how we should think about your cost advantage relative to competitors improving in this sort of new raw materials, large catalysts cost world?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Yeah. I think, I'll just back up a little bit, Hassan, if you look at like a decade ago, our foundational earnings for acetyls were in that $300 million to $400 million. And then if you go as recently as, even last year, we were saying, we think our foundational earnings are around $800 million and that was based on continued

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rationalization of our footprint, expansion activities we had done, work we had done to improve the productivity of our sites, whether it be energy efficiency or catalyst recovery systems and things that lowered our cost of production. And now we're saying, we think that base level is greater than $1 billion.

And so it's really the same thing. I mean, it is productivity, it is energy efficiency. But it also is this market dynamic that I was talking about. I mean, if you go back a decade, we had really overbuilt in China. But the industry had overbuilt in China. And, we were at low utilization I mean, mid-60s to growing to mid-70s. Now, we're at much higher level of utilization with no new capacity other than our own on the horizon and maybe a few other little things around the globe.

And so, we are just in a much tighter area of supply demand, which we expect will continue for the next five to seven years, unless someone else builds new capacity, but it will take them that long. And that's really why we're saying that foundational earnings is really kind of the lowest we think we will achieve in any given time is now at about that $1 billion level. Now, obviously, that could change with a global economic recession or something, I mean, but I'm just saying in normal economic conditions, we think that's the floor.

And I think it really demonstrates also the power of the model that we've developed over these last 10 years where we are able to, as we did in the third quarter, we had a 15% decline in the price of acetic acid in China. But we were able to recover that with the price in the Western Hemisphere because we still had tightness in the Western Hemisphere. And we had 8% less earnings from acid globally in the third quarter than we did in the second quarter. But we were able to recover that in margins for VAM and VAE and other downstream derivatives because – and having that flexibility to shift geographically and having that ability to flex in the chain is what gives us confidence that unlike many of our competitors who don't have that flexibility, we will be able to deliver that $1 billion of foundational earnings going forward.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

That's very helpful, Lori. Very helpful. And as a follow-up, again, reverting back to your prepared remarks, your commentary about relatively tepid long-term sort of supply growth I found super interesting, particularly as you sort of talked about China. Would love for you to dig a bit deeper into that. I mean, you're talking about how the whole sort of capital cost advantage in China has dwindled, the whole permitting process is far more complex. I mean, to me, that sounds super bullish not just for the Acetyl Chain, but for commodity chemicals in general.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

No, I think that's right. I mean, look, not that many years ago, we would have said there was a large advantage to building in China just from a speed of build and a cost of build. As China has developed, as they've developed a stronger working class, I would say that advantage doesn't exist anymore, not in the same way. Now, look, we're still bullish on China. We still are bullish about our operations there. But that advantage of being in China just as a place to be because of lower cost materials doesn't really exist anymore.

Now, there are other reasons to be in China like we are, which is making things in China for the China market, which continues to be a great market. But making things in China for export, not so attractive anymore. And I think that's true for other commodities as well and for other regions of the world as well. And I think also with the supply chain issues that we've all experienced this year, I think our strategy of making locally for local demand has proven to be a good one and probably one we'll see others start to follow as well.

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Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Very helpful, Lori. Thank you so much.

Operator: Thank you. Next question is coming from Michael Sison from Wells Fargo. Your line is now live.

Michael Sison
Analyst, Wells Fargo Securities LLC
Q

Hey, good morning. Nice quarter again. In terms of your commentary on the cost curve for the Acetyl Chain, where are we now in terms of the advantages? Is the rest of the world three, four times more expensive or higher? Just curious how that has changed relative to the footprint you have in the States.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Yeah. Look, still, although we've seen increases in natural gas in the United States, the acetyls produced in the United States, especially for us at Clear Lake with our technology, with the economy of scale is still very much on the lower end of the cost curve. And I would say quite significantly.

China coal had gotten more expensive even than Singapore for a while, because Singapore was oil based. But coal has gone up. Oil has gone up. So I would say what we're seeing is while the entirety of the cost curve has gone up, it hasn't really changed the dynamic about the very large advantage that we have in the Gulf Coast of the US versus the rest of the world.

Michael Sison
Analyst, Wells Fargo Securities LLC
Q

Got it. And then for your outlook for 2022 in EM, I think you commented organic growth of mid- to high-single digits in 2022 and maybe in 2023. That assumes auto doesn't grow in 2022. And then in 2023, do you think auto grows and that growth rate is higher?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Yeah. I think on a simplistic level, yes. I mean, I think, look, we have growth in 2022 just not in auto. We have growth in medical. We have growth in electrical. But I mean, we also do expect to have some lingering impacts of the shortages of resins, glass, and flame retardants as we go into 2022. So, I would expect a higher level of growth in 2023 based on the regrowth in auto and hopefully the full resolution of all those supply chain issues.

Michael Sison
Analyst, Wells Fargo Securities LLC
Q

Great. Thank you.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Thanks, Mike.

Operator: Thank you. Next question today is coming from Ghansham Panjabi from Baird. Your line is now live.

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Ghansham Panjabi
Analyst, Robert W. Baird & Co., Inc.

Q

Thank you. Good morning, everybody. I guess, Lori, relative to your outlook for the AC segment from three months ago, is it purely the curtailments in China and the impact on pricing that is driving that better view on 4Q EBIT? Or is there anything else as it relates to demand or mix or even higher feedstock costs? And then related to that, just your thoughts on how you see curtailments playing out for 4Q specifically and the risk on the first quarter as well?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, we have baked in already for fourth quarter, so let me start there. I mean, look, we're seeing very modest curtailments in fourth Q. I mean, the difference is in third Q, it had all happened in about 15 days, and in the fourth quarter, the provinces know the number. They've been able to optimize more.

And so, we're seeing only really modest curtailments in fourth quarter. And it's a period typically where we have seasonality and we weren't expecting much this year. But I would say that's fully baked into our fourth quarter. But clearly, those curtailments and the impacts they're having on others as well, as well as the curtailments we had in the third quarter has changed our view of how long this pricing situation is going to last.

People are not going to be able to rebuild inventories now in the fourth quarter. And so I think it just pushes that higher range of pricing further into 2022 as we do fully expect people once prices start to moderate, even at what are still fairly high prices, they will want to rebuild inventory, especially because we're already be going into the next construction season at the end of 1Q.

So, I think that really accounts for the change in our outlook for 2022 is just this continued level of higher pricing, higher margins for Acetyl extending longer into the year now than what we thought a quarter ago.

Ghansham Panjabi
Analyst, Robert W. Baird & Co., Inc.

Q

Got it. And the thesis points you, sorry? I was going to say, the thesis points you laid out in your prepared comment, specifically China and the capacity additions and the unlikely nature of that just based on that the world hasn't changed over the past decade along with the economics, does that also impact, on the same basis, your own supply chain and your own access to material, et cetera? How are you sort of thinking about that risk aspect?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Like, I said, we've had – I mean, we've had some issues around materials for additives and that applies to powders and things as well, things you never even hear about or think about. But I would say, in a major way, we make 35% to 40% of our own CO. We start very far up in the value chain and we go very far to the end.

So, again, I think what we're seeing now in raw material, I mean, while it certainly has impacted us, I think we've also had more ability to deal with that because we have more choices in the chain where we can make decisions that ultimately help maintain or even in some cases, improve our margins relative to others.

Ghansham Panjabi
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks so much.

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Operator: Thank you. Our next question today is coming from P.J. Juvekar from Citi. Your line is now live.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Yes. Hi. Good morning, Lori.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Good morning.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Couple of things on your Acetyl Chain's commentary that sort of piqued my interest. First, you talk about catalyst cost going up due to precious metals pricing. How big is the catalyst cost and is it just the raw material inflation issue with precious metals or is there a availability issue of catalysts?

And the second question there, you talk about the capital advantage to build capacity in China versus US is now negligible, which is very interesting because steel costs are the same everywhere and they always had cheap labor and China was exporting deflation all these years. Do you think that's behind us or is it permanent? Thank you.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Let me talk about catalyst costs first. I mean, we haven't really shared the numbers, but earlier in the year, let's go back to like first quarter, second quarter, we actually saw costs for some catalysts we use, precious metals, think rhodium, think platinum, think these sorts of things, we actually saw it increase by 10 times versus what we had had in previous year. Now, a lot of these same materials go into other applications, they go into catalytic converters. And back when auto was really picking up, we really saw a lot of competition for that limited supply of precious metals.

Interesting enough with – but not surprisingly also, with the reduction in auto builds, not so many catalytic converters being built, we've actually seen some moderation back to maybe now only five times what it is. So I would say precious metals...

[indiscernible] (00:34:51)

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

...but we have seen some moderation. And I think the volatility we're seeing in pricing there is just typical of the volatility we're seeing around the world where a lot of pent-up demand, people really wanting to produce, but a lot of, I would say, almost worsening issues around supply chain logistics and everything else, which is keeping all of these markets quite volatile. But I would say volatile at a much higher level than we enjoyed, say, just even two years ago.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

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Okay. And then on the steel side – the capacity?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. On the steel side, you're right. Well, steel kind of costs the same around the world. I mean, it used to be an advantage in China probably due to some government support. I think a lot of that is gone now. So I think cost of materials in China is really not that much less, labor – not necessarily versus the US, but versus maybe other parts of Asia, the labor has more normalized, I mean, I think labor is still a bit more expensive in the US, but you also get a bit more productivity in the US. So, I'm just saying that the difference in – whereas it used to always be a 2 to 1 advantage to build in China versus the US or any other part of Asia and you could do it and you could get through permitting and things more quickly, that benefit has vanished. Is there still a 10% advantage? Maybe. But it's not as large as it used to be. And that's really what I was referring to in my previous comments.

But again, it still makes sense to build in China if you're building for materials that are going to be consumed in China because you get around any tariff issues or any trade warrant issues, transportation, logistics issues. So it can still make sense to build in China. I'm just saying we would not see the advantage of building in China for something we're going to export to some other part of the region or some other part of the world.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Right, right. With the demographics in China, do you expect sort of these labor costs rising that will continue in the future?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Look, I think as the war for talent continues in all parts of the world now, I expect we are in for a period of inflating labor costs really in every region of the world.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Great. Great. Thank you for that color. Thank you.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Thank you.

Operator: Thank you. Next question today is coming from Bob Koort from Goldman Sachs. Your line is now live.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Thank you so much. Good morning. Lori, you mentioned you thought maybe auto is a big flat. Is that an industry comment or because your EV mix is getting richer, you can still grow and what's the latest on the medical stuff? I know during the peak of COVID, you had some diminished demand because of deferral of elective procedures. How is that end market trending at the moment?

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Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, I would say we expect auto builds to be flat year-on-year if you look at the industry and globally. Now, I think that changes region to region. I think Asia is doing a bit better. I think Europe is doing a bit worse. I think the US has been between there. I think that's pretty consistent though with an industry view on auto builds.

I think – while we all hope the chip shortage was going to improve, I think now every most things you read by knowledgeable people say it's probably the end of next year before that starts to improve. So, our expectation is auto builds will continue to be flat year-on-year.

Our own – what that means for Celanese, so maybe I should call that out because I think it's important, is actually we expect our auto volumes to be up 15% next year versus where they were this year, just really as driven by the mix that we have. Again, the higher exposure that we have in EVs than we used to have. EVs have a higher kilogram per vehicle, the presence we have in lithium-ion battery's separator films enhanced by the expansion in Bishop that we'll finish here at the end of the year. So, again, industry-wide, we expect flat auto builds. We expect though our volume into auto to continue to grow by 15%.

And I think your last question, Bob, I had a little problem hearing it, I think was really around elective procedures for medical and what we're seeing there.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Yeah.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. So, what I would say is on medical, elective procedures have been flat this year. We kept calling out we expected them to increase. We also didn't expect the Delta variant. And so, what we're really seeing is they're still flat. We're seeing a little bit of pick up in some regions, but I would say nothing of significance in terms of our orthopedic side of the medical business.

What I will say, though, is we have seen a notable pick up in our business for other medical and pharma. And it's really on the back of our focus. We put on this in our strategy in 2019, trying to expand our presence in other parts of medical and pharma, and we did see an increase in that in third quarter, which is really what helped kind of keep our mix pretty steady versus second quarter.

And just as an example of the kind of projects that we're bringing in now in medical outside of orthopedics, we've actually just closed a deal to provide POM into dry powder inhaler for a company in India. So, this is for an inhaler, uses dry powder, uses our POM. This is a high-value application with pretty good – not just good margins, but good volumes going forward. So – and that's really where we're starting to see more growth, higher margin business, things like inhalers, things like wearable diabetes devices, obviously still continuing to grow our VitalDose, long dose delivery platform. I mean, we are seeing really good growth in these segments and expect that to continue into next year and beyond.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Perfect. Thanks so much.

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Operator: Thank you. Next question today is coming from David Begleiter from Deutsche Bank. Your line is now live.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Good morning.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Lori, going back to your cost curve comments in China, how much of this change do you think is permanent? Is any of the 20-odd plants there you think at risk for perhaps permanent shutdown?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Well, I mean, this is my personal belief. I mean, I think, the advantage to build in China has disappeared and I think that's probably permanent. I think it's, like we see generally as developing economies get more developed and strive to get a bigger middle class, strive to increase wages, strive to improve the quality of life for people in that company, they do lose their cost advantage over time. Now, they've gained in productivity.

So, I don't think in fact, it's going to switch. I don't think it's going to get cheaper to build in other parts of the world. But, honestly, I don't think China's ever going to go back to being the super low cost producer that it once was and that's not necessarily a bad thing, right? We see China also moving to create more high-value materials, more things in China to meet the growing demand of the population in China. So, I just don't think they'll always be the huge low cost exporter that they once were, but we've seen many economies go through that, right?

And so, who knows what the next economy will be? But they're still the second largest economy in the world. So there's no doubt China will remain a very important part of the world balance, and certainly, the chemical and polymer world balance in terms of where things come from.

Scott A. Richardson
Executive Vice President & Chief Financial Officer, Celanese Corp.

A

David, and I think if you really looked at technology difference that we've talked about for a long period of time on just the straight variable cost, the advantage that we have is still there. And with some of the challenges we see in coal and just fundamental usage of coal and that being more and more restricted over time in China, those plants operate at a slightly lower level.

And Lori talked about catalysts. Catalysts, usage of these disadvantaged technologies is higher than what ours is. So we're seeing the cost increase. They're seeing the cost increase at a greater rate. And so that should hopefully – and that's kind of why we signaled strength as we work our way into 2022 is we do think that there is some changes here that we do believe are sustainable. Then you layer on the fact that supply/demand utilizations are getting into the 90% range.

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David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

On the back half of the year, due to the costs you mentioned, you mentioned there should be similar pressures next year. Do we return back to, maybe in 2023, prior levels of Tow earnings once these costs normalize?

Scott A. Richardson
Executive Vice President & Chief Financial Officer, Celanese Corp.

A

David, we lost about half your question. Do you mind re-asking that for us?

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Sorry. On Acetate Tow, you've had a step down in earnings here in the back half of the year due to inflation. I guess, you've highlighted additional – these pressures continuing into next year. Would you expect to return to normalized levels of Tow earnings perhaps in 2023?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, I think that's a very reasonable assumption. I mean, the real issues – other than the issue we have with – losing Belarus volumes this quarter, but we'll place those volumes into other applications next quarter. The things really driving the lower level of Tow margin is acetic acid pricing, is natural gas pricing.

So as we get to 2023, just as we expect normalization for acetic acid, we would expect normalization in pricing, and we would expect to see margins for Tow come up to the level we've seen. As well, of course, that will give us two years to pass through pricing actions on multi-year contracts.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Thank you. Next question is coming from Kevin McCarthy from Vertical Research Partners. Your line is now live.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Yes. Good morning. Lori, I had a few related questions on natural gas. I think you made the points in your prepared remarks that due to low levels of inventory, the costs are flowing through maybe a little bit faster than would otherwise be the case. And so with regard to your 4Q earnings guidance, do you think that natural gas or energy inflation will be net positive, negative or neutral? And then the second part would be related to recovery of those costs. I think you mentioned that you're implementing surcharges, so perhaps you could comment on where you're doing that, if it's Europe or other places and which products?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. So if we look at natural gas, I mean, obviously, natural gas is an issue in the US where we purchase about 55 million BTUs annually. But it's also a real issue in Europe where we don't necessarily purchase much natural

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gas directly, but we certainly see it as a factor in many of our raw material costs, as well as a factor in our steam and other things that we purchase from others. And so it has been a significant factor this year in third quarter, a step-up from second quarter. In fourth quarter, we do expect to see another, call it, 25% increase in the US and nearly doubling of natural gas prices in the EU. So this will be a significant factor for us in the fourth quarter.

Now, with the surcharges, with other things, we do expect we'll be able to recover some of that. I think though, we will see, for example, in EM another $20 million increase with the surcharge, we're recovering some, but it means we're probably just going to flat to third quarter to fourth quarter. Not every contract can we put a surcharge on, not every molecule has a surcharge. Some are contracts are fixed for a short period of time. So we won't be able to recover everything, but we do think we'll be able to basically mitigate the impact of the increase from third quarter to fourth quarter.

If we stay in the winter months next year, we'd expect first quarter to be kind of the same level of pricing we see in the fourth quarter. But, again, we have been able to pass more of those costs on. So we should see a bit of help as we move into next year as it comes to the impact of natural gas pricing on our overall margins.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC
Q

I see. That's helpful. And then secondly, if I may, want to ask about the 8 kilotons of production lost in the EM segment. You commented on availability issues around glass fiber, flame retardants, resins. Just wondering if you could kind of talk through those and are they getting any better or worse as far as you can tell in the fourth quarter and beyond. What's your outlook there in terms of ability to produce?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.
A

Yeah. Look, unfortunately, I think it's going to be similar in the fourth quarter, we don't really see an improvement. I mean, glass fiber demand has surged and the ability of the providers to respond to that, especially post-freeze is just – it's just hard to get them back on and get the production up. So I don't really see probably an improvement in glass fiber in the fourth quarter. We do expect to start seeing some improvement next year.

Similarly, flame retardants, I mean, that one's a little even more complicated because pretty much all of the yellow phosphorous that's used to make flame retardants comes out of Yunnan province in China, which was curtailed as part of the energy curtailments in Q3 and will probably be impacted in the fourth quarter. So, that situation is not going to get better, probably again this year, hopefully, will get better next year. But there right now is just a single source of this raw material and it happens to be in China. So we need a bit more time to understand what the energy curtailments are going to mean going forward to really know when that issue is going to resolve itself.

And resins, I would say, are mostly resolved at this point in time. I don't expect resin availability to be as much of an issue in the fourth quarter and certainly not as we move into next year.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC
Q

Perfect. Thanks so much.

Operator: Thank you. Our next question is coming from Matthew DeYoe from BoA. Your line is now live.

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Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

Thanks. I don't expect you to comment on market rumors, but there was one earlier this summer about more or less the ceramics for medical and industrial products companies. And without talking about that one more specifically, I guess, can you help us frame out the scope at which you're looking through valuation – M&A and kind of what would fit into the model and what wouldn't fit? Because it seems like the search is fairly wide, I guess, that's – if we can start there.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, I think as it comes to M&A, whatever you're hearing, I would assume we're looking at everything. Anything that is related to end markets that we currently serve, anything that's related to resins that we currently produce or might want to – or polymers that we might want to produce, I would just assume if there's a rumor, if you see something, we're probably looking at it.

Now, that said, we look at everything with a lot of discipline and we look at it through the lens that we laid out at Investor Day. So we really focus on can we achieve synergies with it. What do we think is our unique ability to get value creation from it. So is it something that we can provide our business models, our project pipelines, our growth models, too. All of those criteria, where do we think it is in the value chain? We look at – but we look at everything. We choose very few things to pursue. And so, maybe I'll just stop at that. What I will say though, is we think we have a lot of managerial and financial bandwidth in order to complete transactions of any size or multiple transactions of a smaller size.

So, at the time of the Investor Day, we said we outlined about a $6 billion – having $6 billion available on our balance sheet in order to do M&A. I will tell you, even with the expected close of Santoprene here in December, we still think we have about $6 billion available to us on our balance sheet because of our higher earnings that we've had this year and what that's meant in terms of cash generation and where our balance sheet is at.

So, I mean, assume we look at everything, assume we continue to look at it through the criteria we laid out in Investor Day and know that we have a very large pot of money ready to go when we find the right opportunity and we have a management team that's ready to both negotiate and integrate.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

That's helpful. Thanks. Then I want to talk about a little bit on the EM side with the nat gas costs. I guess, I was a little surprised that downstream ops would have that much exposure directly to nat gas. Is that just a reflection of like European energy costs moving up or is nat gas more directly a feedstock to or is that just the acetic pass-through, I guess? I'm just wondering.

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Well, I mean, if you think about it, in the US, just about everything is a derivative of natural gas. So, even in the US, we've seen almost a doubling of nat gas costs from, say, last year to this year – to the current price this year. But if you think about CO, if you think about methanol, I mean, in the US, these are all natural gas derivatives. So, there is a kind of direct correlation to raw material feedstock.

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Having natural gas though for us still from a energy standpoint, like boiler, this is very small because actually acetic acid is exothermic, it's heat integrated with others downstream. So not – kind of the inverse of what you think. It is a big deal for raw materials. We tend to be able to pass that through, not such a big deal in terms of direct cost of energy in our US operations.

In Europe, again, more EM exposure. Most EM tends to be lower energy intensity, so things compounding really doesn't require much energy. But something like POM requires a lot of energy. So, you think about POM, right? You have to heat it. You have to crystallize it. You have to dry it. It's that takes a lot of energy. So there, we really do see the direct impact of natural gas, which is almost doubled from third quarter to what we expect in the fourth quarter and is kind of four time to what it was in the third quarter or in the second quarter. There you see a very direct relationship and one that's a little harder to pass through because it really has to do with steam costs and electricity costs and all those sorts of things.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

Understood. Thank you.

Operator: Thank you. Next question today is coming from Frank Mitsch from Fermium Research. Your line is now live.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Hey. Good morning, and congrats on a nice result. Just curious with the step down that we're seeing in the Acetate Tow market, can you comment on where you feel that fits within the Celanese portfolio?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Frank, I mean, as you know, we constantly look at everything in our portfolio and look at where we think the long-term trends are and what does that mean for long-term margin results and the fit in our portfolio. What I would say on Tow and similar to my previous comments is, is the step down we're seeing right now is, we think, uniquely tied to the price of acetic acid and energy prices around the globe.

And clearly, the biggest piece of that being energy prices in Europe and for our Lanaken plant. So, we do believe that we'll see a normalization of pricing both raw materials and energy. And with that, we expect to continue to enjoy high margins in Tow. But like all of our portfolio, we'll continue to watch that and make strategic decisions accordingly as we move through the next few years.

Scott A. Richardson
Executive Vice President & Chief Financial Officer, Celanese Corp.

A

Yeah. And Frank, I mean, I think it's important to remember, I mean, this is still between both the base business and the dividends that come out of the JV, this generates a lot of cash for us and that cash can then be deployed for higher growth applications. So, we saw last year the importance of having this business when we saw the downturn, very solid results, very solid cash flow generation. And, yeah, we're seeing some near-term compression. But as Lori said, we do expect some level of normalization.

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Frank J. Mitsch
Analyst, Fermium Research LLC

Q

That's very helpful. And just a clarification, in terms of your energy costs year-over-year, just reading through the prepared remarks. So it's $20 million negative impact in Q3 and then an additional $20 million negative in Q4. So we should assume like year-over-year, higher energy is going to cost you $40 million. Is that correct?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, that's for EM. I would say we've also seen the impact of those higher energy impacts on raw material and that's probably closer to $250 million year-on year. But we've been able to offset all of that, except – anticipate offsetting all of that, except about $20 million in EM through pricing initiative and other initiatives.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Got you. Very helpful. Thank you.

Scott A. Richardson
Executive Vice President & Chief Financial Officer, Celanese Corp.

A

Kevin, let's make the next question our last one, please.

Operator: Certainly. Our final question today is coming from Laurence Alexander from Jefferies. Your line is now live.

Laurence Alexander
Analyst, Jefferies LLC

Q

Good morning. Two quick ones, then. Can you touch on – given the improved structural outlook for acetyls, why not pull forward CapEx to sort of fill in the pipeline, the industry pipeline in 2026 to 2028?

And on carbon pricing, to the extent that carbon prices move higher, are your EM customers giving you any sense of how that factors into pricing for your products? Are you seeing any kind of favorable mix shifts or negative from that? And similarly within acetyls, is there a certain level of carbon prices where some of the Acetyl Chain becomes disadvantaged relative to substitutes?

Lori J. Ryerkerk
Chairman & Chief Executive Officer, Celanese Corp.

A

Yeah. Look, I think in response to your first question, not just for Acetyl, but for EM, we continue to look at our ability to pull forward all of our products because my margins are [indiscernible] (00:58:55) and we believe that that structural demand is there. Similarly, in EM, we can sell everything we can make right now. So – and we expect that to continue as the desire for high-quality unique products like we make continues to grow.

So we actually look at pull – we constantly have been looking at how do we pull all of these up. The limitations are really the actual time it just takes to do a project between permitting which, unfortunately, has been slowed down in most parts of the world because of COVID, all the way to just the ability to get raw materials. And we talked a little bit about steel, the concrete, everything. There's so much demand right now for construction projects that we're finding it difficult to just pull our projects up in a meaningful way. But we'll continue to look at that, and we'll continue to update you as we move through the year.

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And then on your second question, what I would say is, for most of the high-value products that we produce in EM, customers just want the product. I mean, we've had three consecutive quarters of price increases in EM, kind of the first time in our history. And what we find is that is not impacting the desire by customers to take products. So I think, in the inflationary environment we're all experiencing on everything, people understand – they may not like it, but they understand why we're having to push through these price increases to cover raw materials and energy and, again, we have not seen any loss of volume due to pricing.

I would say the same thing really in acid and downstream Acetyl Chain derivatives. The demand for construction products and packaging and all these things that Acetyl is going to is only increasing. And even at the higher prices, I mean, people may be a bit slower to refill inventory at these prices, but there's no material anyway available to refill inventory. So, again, our customers would take more at these prices if we could produce more. We'll just leave it at that.

Laurence Alexander
Analyst, Jefferies LLC

Q

Thank you.

Operator: Thank you. We reach the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Brandon Ayache
Vice President-Investor Relations, Celanese Corp.

Thanks, Kevin. I would like to thank, everyone, for listening in today. As always, we're available after the call, if you have any further questions. Kevin, please go ahead and close up the call.

Operator: Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.

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