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BEHIND THE NUMBERS
Quality of Earnings Analysis

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LyondellBasell Industries N.V. (LYB)
Earnings Quality Update- 9/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are maintaining our earnings quality rating of LYB of 5+ (Strong) and our Top Buy rating.

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

We still consider LYB's results to be very strong in 3Q21. It was the second-highest EBITDA ever posted for LYB. We consider the market reaction overdone. This isn't a high-flying stock with no tangible assets trading for 40x adjusted EBITDA and 100x adjusted EPS. LYB is trading for 5.3x EBITDA and 5.5x EPS and made zero adjustments to EBITDA or EPS. It pays a 5.0% yield with a growing dividend that consumes only 27% of trailing EPS.

LYB set a goal to retire as much as $4.0 billion of debt in 2021. It completed $2.4 billion through September and now $3.1 billion through October. It looks likely to reach the goal by year-end. At the end of 3Q21, net debt (before the October payment) was $11.6b or 1.46x EBITDA – vs. the goal of 1.5-2.0x target. The company does not expect to retire additional debt in 2022, which means much of the remaining free cash flow will be devoted to share repurchases of a cheap stock. Every $500 million it uses to repurchase stock adds 1.7% to EPS growth.

What is strong?

- Demand is still increasing in our view. LYB wants to rebuild inventories but demand remains too brisk. DSI's are instead still declining. This is also fueling more price increases to push revenues higher – LYB beat revenue guidance handily:

	3Q21	2Q21	1Q21	4Q21
Inv. DSIs	45.0	50.9	55.1	59.1

  Until this situation turns around, we believe LYB will continue to see strong pricing.

- At the largest unit, Olefins/Polyolefins Americas (over 50% of EBITDA) – LYB posted flat EBITDA with the record 2Q21 – with some unplanned maintenance outage time and buying more ethylene than their own crackers could produce. LYB took pricing to more than offset feedstock cost inflation.

- LYB recently added about $1 billion to its base EBITDA and has another $500 million coming in 2022 and 2023. There are times pricing will take this figure higher or lower, but the company's mid-cycle recurring EBITDA should exceed $8 billion. LYB has a market cap of $30 billion and will have debt less than 1.5x EBITDA. Free Cash Flow should be in around $5 billion, and the dividend at $1.5 billion would allow them to retire 10% of the stock per year. LYB has a history of hefty share repurchases exceeding $3 billion annually, the share count of 334 million is down from 487 million in 2014.

What is weak?

- The biggest reason for earnings to decline from 2Q to 3Q was a $120 million decline in EBITDA as seasonal demand for polyolefins dropped off as normal. In 2018, LYB saw it fall off sequentially by $93 million. In 2019, it fell sequentially by $40 million which LYB attributed to lower than normal seasonality in demand. 2020 was obviously an odd year and economies were starting to see an upswing after 2Q, yet polyolefins in this unit still fell $40 million. We estimate this $120 million in seasonally lower business cost LYB about 23-cents in EPS.

- The same division saw $10 million in currency headwinds sequentially and $85 million of EBITDA was hit by a lower spread. This unit does not have as wide of a difference for pricing between feedstock options as in the US. These items were about a 20-cent hit to EPS.

- LYB guided to some margin pressures for 4Q from feedstock prices and supply chain issues can impact customers' ordering rates. They still have an easy comp given how strong the demand is at the moment.

What to Watch?

- LYB reiterated that it may sell its refinery in the near future. Historically, this has produced the most volatile results for the company. (See the -$81 million in EBITDA for 2Q21 followed by $41 million for 3Q21).

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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