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LyondellBasell Industries (LYB) 1Q20 Update
Maintain BUY

We are maintaining our BUY recommendation on LYB. The company is confirming its $350 million quarterly dividend as a key part of its return of capital to shareholders, which has a yield of 7.6% on a $55 stock price. The liquidity was strong to begin with but has been recently enhanced – There was $1.8 billion in cash and securities at the end of March and short-term debt of $1.5 billion plus $0.5 billion on the credit revolver. In April, LYB issued $2.0 billion in medium-long term notes and repaid the revolver and $0.5 billion on the US receivable facility. That would leave $2.8 billion in cash on hand against $1.0 billion in other short-term debt (mostly commercial paper of $0.8 billion) and no maturities of long-term debt. Plus, the entire $2.5 billion revolver is untapped.

- **LYB had over $5 billion in liquidity at the end of April.** LYB also expects to see cash flow enhanced going forward by declining working capital adding $500 million. That should fall with lower prices and LYB is cutting DSIs too. LYB also plans a reduction in expected capital spending of $500 million from $2.4 billion. There are also no debt maturities in 2020.

- **LYB still produced $1.1 billion in EBITDA for the quarter. EBITDA generally runs between $1.5-$2.0 billion per quarter, so 1Q20 had some additional negatives hit with the economic slowdown along with some maintenance. However, much of what was hit is focused on fuel sales and that should return more quickly.** The company is pointing out that about half its business goes to consumer packaging and medical. Autos and durable products are 20%-25%. The remaining 25%-30% is fuel related.

- **2020 EBITDA may cover 2020 cash needs without tapping liquidity.** Assuming a 2Q and 3Q that produce only $1.8 billion in total EBITDA for two quarters and 4Q that comes in another weak at $1.1 billion – LYB would have $4.0

billion in EBITDA – against taxes, interest, pension funding of $800 million, capital spending of $1.9 billion, and the dividend at $1.4 billion. The $5 billion in liquidity and declines in working capital appear to be more than enough cushion.

- **LYB saw strong growth in large areas of its business that is likely to continue.** Hardest hit were items related to car production and fuel. Medical-related business, take-out food containers, frozen food packaging, home-delivery packaging all saw strong growth.
  - **"*lifestyle changes are creating a new normal as consumer-based demand for frozen, dairy, and packaged food has risen by approximately 30%.*** *Surveys indicate that after staying at home during the pandemic, 40% of Americans plan to increase the amount of time they work from home and 65% intend to eat at home, more often*." – CEO Bob Patel.
  - Consumer demand surged with pantry stocking for food, medicines, household items, and items shipped directly to the consumer. All of that is part of LYB's end markets. We should add this includes frozen food, fresh food wrapped in plastic or plastic bags, food bought on-line, soap… It's now just restaurant take-out trays.
  - Margins stayed strong too, *"Consumer-driven demand for polyolefins used in packaging and health care products,* ***supported relatively stable integrated polyethylene margins****, in the Olefins and Polyolefins - Americas segment.* ***Lower feedstock prices resulted in higher integrated polyethylene margins*** *for our O&P – Europe, Asia, and International segment.*
  - Even plastic bags are returning, "***Reversal of bag bans on the West Coast on the East Coast those could stay for a while. I think what people are realizing is that there are very significant hygienic benefits to plastics and that single-use has benefits."***
  - Lower oil prices and reduced driving hurt the refinery and oxyfuels – but that should recover. *"In oxyfuels, we should start to* ***see some benefits from the volume rising****.* ***Higher oil price also helps in terms of oxyfuel profitability.*** *So, both should directionally improve as the lockdowns are eased and as activity at least daily activity returns to more normal levels."*
  - That leaves durable goods like new cars, which will likely take longer to recover.

- **The dividend has been confirmed as well.** *"In terms of capital allocation, we're very consistent in our view that **<u>the dividend is a high priority for us</u>** coupled with a strong BBB or investment-grade rating, which today is BBB for us. So, I don't expect that we would undertake buybacks given that we're prioritizing liquidity. **<u>Our dividend we expect that we will recommend the May dividend to our Board. We expect that they'll approve that dividend for Q2.</u>**"*
- **LYB talks a great deal about its ability to use multiple types of petroleum feedstocks – Oil-based naphtha or Natural Gas Liquids like ethane, butane, propane. We have pointed out for years that LYB has a cost edge over non-US chemical plants when Oil is priced above 8x Natural Gas. It currently is with Natural Gas at just under $2 and the low point for gas was $1.60.**

- **A lack of drilling is unlikely to disrupt this cost advantage in the near term either.** Ethane (an NGL) is still being produced in quantities greater than the market needs and it is simply being burned as natural gas in power plants. Plus, current wells continue to produce, and new gas pipelines are ramping up, bringing in more supply. Much of the NGLs are found with oil production so if slower drilling drives up NGL prices, it should also push up oil prices and keep the cost edge in LYB's favor.

- LYB has more maintenance scheduled for 2Q as well – taking capacity offline now should help other facilities operate at higher levels and help margins.

Explanation of EQ Rating Scale

Rating	Description
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 Concerns"	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 may 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 the next quarter. 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.

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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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