BEHIND
THE NUMBERS
Quality of Earnings Analysis

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LyondellBasell Industries N.V. (LYB)
Earnings Quality Update- 6/21 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 at 5+ (Strong) and maintain our Top Buy rating.

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

Summary

LYB beat 2Q21 forecasts by 50-cents. There were no adjustments to GAAP EPS (not even marks to the Lower of Cost or Market for inventories as prices are rising) and the higher equity investment income is coming from businesses experiencing the same increased prices and demand for their production. The tax rate at 19.7% isn't giving a meaningful tailwind. R&D is up as is SG&A. The earnings quality looks very strong.

What is strong?

- Cash flow came in much higher than we expected. We thought LYB would see more working capital drain on cash from operations due to commodity price inflation.

	2Q21	1Q21	4Q20
Net Income	$2,059	$1,070	$763
EBITDA	$3,018	$1,585	$1,264
Cash from Ops	$1,902	$571	$743
Wrk Cap Chg.	-$935	-$626	-$203

The working capital increase was larger, but the income rose even more. It is also important to realize that the inventory DSI's actually fell to 50.9 days from 55.1 after 1Q21 and 59.1 after 4Q21. Thus, demand is so strong LYB still cannot rebuild its inventories and management talked about filling orders "hand to mouth" as everything remains tight.

- Pricing is rising and that is carrying EBITDA higher. LYB said it raised prices every month this year and August orders look the strongest of the year at this point. Looking at the Americas unit, EBITDA rose from $867 million to $1.576 million from 1Q21 to 2Q21 – only about 20% of that gain was volume. Europe and Asia grew sequentially from $412 million to $708 million with a slight drop in volume. Intermediates had a small volume gain and rose by $414 million.

- LYB continued to retire debt after its $2 billion in acquisitions in late 2020. It paid down $1.2 billion in 2Q21. Net debt is now $12.7 billion compared to LYB's goal to push it below $12 billion. The debt rating was boosted by S&P and leverage is currently 2.05x trailing EBITDA, which includes two very poor quarters. On the current run rate, we expect LYB to be under its 1.5-2.0x target by year-end.

What is weak?

- LYB is still not hitting on all cylinders. The Advanced Polymer Solutions unit has posted basically flat results for the last four quarters. It is a victim of the semiconductor shortage impacting car and appliance production. We have seen National Instruments pointing to this problem improving in 4Q21 and creating strong demand in 2022.

- The refinery is still losing money at -$81 million in EBITDA in the quarter. Jet fuel demand remains at low levels and some of the pricing of byproducts is weaker too. This remains a small part of LYB, but having it reach break-even or post a small profit will improve results further.

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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