

LSB Industries Inc. (OP): 3Q20 First Take: Stable onstream rates drive volume growth amidst weak pricing environment

Our take: LXU reported adj EBITDA of \$10mn vs our GS estimate of \$14mn (and above one Bloomberg consensus estimate of \$3mn). We think the earnings miss will be somewhat telegraphed by weak earnings from industry peer CF (which also experienced softer pricing and higher natgas costs). Although LXU noted substantial ag-pricing declines (driven largely by the oversupply of ammonia and UAN in LXU's primary end markets), we remain encouraged by another quarter of stable operations which allowed substantial increases in volumes (+19% in Agricultural, +13% in Industrial, and +6% in Mining) across the business. As demand in both the ag and industrial sectors recovers, LXU expects a reduction in the current ammonia inventory buildup to benefit pricing. With its expectation for continued operating performance improvement and its recently announced new customer agreement (7-year contract to supply between 70,000-100,000 additional tons of nitric acid annually, which it expects to yield meaningful incremental EBITDA in 2021), management sees prospects for mild growth in 4Q20 and 2021.

For more detail on our expectations coming into the quarter, see Chemicals: Initial thoughts on potential policy implications and updated models heading into 3Q earnings season (9 October 2020).

3Q20 highlights: LXU reported 3Q20 adj. EBITDA of \$10mn (which compares to our estimate of \$14mn). LXU noted a 19% y/y increase in fertilizer sales volumes (including a 33% increase in UAN volumes). From a pricing perspective within agricultural sales, UAN decreased by 20% y/y, ammonia by 28% y/y, and HDAN by 24% y/y. Management noted plant operations remained stable during the quarter and that LXU benefitted from the absence of any turnaround activity in 3Q20. Leverage as of 3Q20 was 8.9x (8.2x net) vs 10.3x (9.2x net).

Market outlook: Looking ahead, management is cautiously optimistic that emerging demand trends point to improving sales volume and pricing. On the ag side, LXU expects stronger corn prices (as a result of the USDA making downward adjustments to its corn crop and ending corn stock forecasts) to result in higher plantings in 2021 which could translate into a robust fall ammonia application in the coming weeks and boost demand for orders of UAN and HDAN for the 2021 spring planting season. On the industrial and mining side, while the effects of COVID-19 continue to weigh on the economy, management is seeing

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gradual improvement in demand for nitric acid, industrial ammonia and ammonium nitrate as sectors such as auto manufacturing, home building, and copper mining have increased activity.

Our view: Our view on LXU is based upon improving on-stream rates (which we believe has been the case so far in 2020) and stable ag-market demand (fairly insulated from COVID-19 disruptions) driving earnings/balance sheet improvement. We think gradual earnings improvement could raise bondholder upside in the event of a refinancing (which management has expressed interest in pursuing as LTM EBITDA approaches \$100mn). However, we see increasing risk that natural gas costs may rise in 2021 and could put pressure on LXU margins, which may come at a time when the company begins to revisit plant maintenance and could add additional earnings pressure.

Risks to our rating: Downside: Operational disruptions or additional planned maintenance outages, nitrogen capacity additions, increase in natural gas prices.

Disclosure Appendix

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