

January 28, 2020

## Daily Chemical Reaction

### Petrochemical Price Trends & Other Items

#### Commodities Mentioned:

- US Natural Gas
- Brent Crude
- USGC Ethane
- USGC Propane
- USGC Butane
- Ethylene
- Propylene
- Benzene
- Methanol
- Polyethylene
- Polypropylene
- PVC
- Caustic Soda
- Silicones
- Polysilicon

#### Companies Mentioned:

- Westlake
- Olin
- Huntsman
- Dow Chemical
- CP Chem
- Covestro
- Kraton
- Sasol
- LyondellBasell
- Wacker Chemie
- PolyOne
- Shin-Etsu Chem.
- Ashland
- Trinseo
- Petronas
- Tata Motors

#### Key Points:

- Cheap US Nat. gas/NGLs are currently an anticipated 2020 benefit for US chemical producers – derivative price trends and demand are now in focus.
- Other Chemical items of note: Mt. Belvieu Butane Strength; Four earnings reports that stood out to us; Four other items (caustic, methanol, etc.) of note

▪ **Petrochemical price trends** are in focus. A basic observation from our discussions after publishing our weekly catalyst report yesterday was that most are aware that US natural gas and two key NGL (specifically chemical feedstocks ethane and propane) values decreased relative to crude oil in late 2019/20. We highlight an OPIS view today that discusses length in NGL markets through 2020 and includes a webcast discussion – see in [LINK](#). We view this as the consensus at this point and find chemical sector investors focused on the equities that could potentially see strength as management teams highlight a low-cost US base and upward price support in their derivative products, such as polyethylene (PE) and poly-vinyl chloride (PVC). We flag the latest PlasticsExchange report in [LINK](#) and a Platts Petrochemicals Americas weekly report in [LINK](#) to show that news of petrochemical price strength is broadly in the news beyond our weekly update, and most are aware that margins are down YoY, as noted in the ICIS report and chart in [LINK](#) discussing PE, but are trying to evaluate whether the worst is behind the commodity producers, such as Dow Chemical, LyondellBasell, Westlake, CP Chem, etc. Our initial view of the early year support/strength in some chemical chains and a few noted items of note, such as the premiums in US benzene and methanol values (relative to China spot), is that these early-year cost headwinds for some non-integrated derivative product players, such as Huntsman, Covestro, Trinseo, Kraton and Celanese to name a few, will likely prove temporary – with the final ramps of the first wave of petrochemical capacity fully online on the USGC along with new production additions in Asia/China, we do not foresee a setting of tight intermediate product conditions persisting unless crude values surge higher. Thus, in our view, the more downstream companies facing uncertainty cost and demand conditions are likely to issue conservative full year 2020 profit guidance, but we advise investors to take notice of this sub-sector arena as overreactions could occur and provide an investment entry point. We take a more selective view of the commodity space, as we generally see a tightening setting ahead of MDI-polyurethanes and also take a positive view of US PVC (especially given the potential for the [Orbia strategic review](#) to spur western world consolidation of this market that is much more complex than most investors appreciate), while we generally take a more cautious view of PE (we tend to view it more as a cashflow engine for US producers than a growth driver) and view the polypropylene market as most likely to shock the investment community to the downside in 2020 as a result of significant capacity additions set to start up this year (we model ~7% global PP capacity growth YoY in 2020) – Lyondellbasell, Braskem and Formosa are major producers. As noted in our first C-MACC Scenarios piece today, outside of PVC we see limited near-term risk of consolidation, with a very wide valuation gap between possible buyers and sellers.

#### Other Chemical items of note:

- Our industry discussions point to mounting concerns with the **coronavirus** [LINK](#), not only from the potential direct product demand impact but also from the stand-point of backing up supply chains. Plants will continue to run and we see the potential for inventory builds at the producer level, which would put downward pressure on petrochemical and polymer prices, especially polyethylene give China's normal import requirements. We flag another article in [LINK](#) that points to recent weakness in crude/naphtha – we also noted this in our weekly catalyst report, and it only adds to our confidence that a cheap raw material backdrop is likely (with the near-term petrochemical price/input cost increases discussed in the first paragraph quickly met

with increased global production and potential significant over-supply). For non-integrated derivative players in a number of areas (coatings, urethane systems, compounded products, etc.) this would be good news if their end markets remain robust.

- **Mt. Belvieu butane** values have increased ~23% YTD, while other NGL values have fallen. Strong export demand appears to be a major driver – see Platts update from Friday in [LINK](#). We view this as a headwind for Huntsman – see [LINK](#) – and highlight a public report on the global maleic anhydride report in [LINK](#) that focuses on the impact of adding capacity in Russia but lays out the global market well enough to give a general perspective on Huntsman’s relative position. We do find that maleic anhydride spot market strength has developed in China - see [LINK](#) – but it does not appear to be as pronounced as the likely move in input costs among major producers, in our view..
- **Four chemical sector earnings reports worthy of note today:**
  - **Ashland** reported preliminary 1QFY20 results [[LINK](#)] and held an earnings conference call today [slides in [LINK](#)]. Two things stand out to us:
    - Demand is currently weak but management has an market demand view that reflects likely improvement. Did not provide FY 2020 or 2Q guidance.
    - In adhesives, mgmt. sees general softness across most segments, especially in transportation, but strength in construction. Coatings demand was also soft in 4Q. Most of the call was focused on its restructuring initiatives.
  - **PolyOne** reports full-year 2019 results [[LINK](#)] this morning. Two things stand out to us:
    - The company reported better than expected results in its Specialty Eng. Materials segment, including record profit from Advanced Composites.
    - Beyond the quarter review, most of the discussion on the earnings call targeted its transformation toward more specialty products/profit [est. 85%+ of EBITDA post [Clariant deal](#) per mgmt.], and mgmt. notes an expectation to grow the bottom-line double digits in 2020 [ex-Clariant]. We see the raw material backdrop as unlikely to pose a risk to this YoY growth expectation.
  - **Wacker Chemie** reported 4Q19 results [[LINK](#)] today and we flag the earnings call slides in [[LINK](#)] – Two notable items stand out to us:
    - Slide 4 in earnings call presentation notes lower prices YoY in silicones but also that the market appears to be normalizing after tightness in 2018. In our view, Dow Chemical silicones will likely also report similar (though well-expected) headwinds with its 4Q19 earnings release tomorrow.
    - The polysilicon results were better than anticipated driven improved sales and better costs/mix offset lower prices YoY (slide 7) – a plus for DuPont.
  - **Shin-Etsu Chemical** reports consolidated financial results for the first three quarters of FY2020 – see [LINK](#). A few things of note from the release.
    - See page 4 in the release above, mgmt. notes improved conditions in PVC in Jan. 2020 – this aligns with our view on prices, and management anticipates market conditions in caustic soda to recover.
    - The company is in the process of starting up the ethylene production plant on the USGC per the release – we see this as a negative for ethylene in the Louisiana market given that the Sasol ethylene plant appears to be running partly on a merchant basis given the LDPE unit is currently offline [[LINK](#)].
- **Four other items in the news worthy of note:**
  - Tata Motors launches Nexon EV in push to accelerate EV adoption in India – [LINK](#).
  - The Petronas Labuan Methanol facility in Malaysia recently faced operational issues – one line has no restart date, and the other is not set to be back in full operation until mid-Feb. See [LINK](#). Along with SE Asia strength, we flag China methanol price strength YTD in [[LINK](#)]
  - NW Europe caustic soda 1Q contracts fall 10% - see ICIS report in [LINK](#). This is a negative for chlor-alkali producers, such as Olin, Ineos and Westlake, if the headwind can not be offset

in their chlorine derivative products. We see Westlake and Ineos having a better shot of doing this than Olin.

- 3M issues a 2020 profit view that misses expectations as it foresees weak China demand [[LINK](#)] – our recent corp. meetings and the coronavirus headlines also support a cautious stance on China.