Dow Inc. (DOW)

Updated June 1st, 2019 by Josh Arnold

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	13.4%	**Volatility Percentile:**	00.1%
Fair Value Price:	$53	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	44.0%
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.4%	**Growth Percentile:**	36.2%
Dividend Yield:	6.0%	**5 Year Price Target**	$67	**Valuation Percentile:**	56.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	63.4%

Overview & Current Events

Dow Inc. is a brand new standalone company that was recently spun off from its former parent, DowDuPont. That company has broken into three publicly-traded, standalone parts, with the former Materials Science business becoming the new Dow Inc. Dow began trading on its own on April 1st, 2019 with the ticker DOW. It should produce about $46 billion in revenue this year and trades with a market capitalization of $35 billion.

Although Dow was still part of the former parent in the first quarter, the company released its own first quarter earnings report on 5/2/19 in anticipation of the spinoff. Total revenue fell 10% year-over-year, in line with prior guidance, to $10.8 billion. Volume grew 1% overall as Industrial Intermediates & Infrastructure gained 6%, while Performance Materials & Coatings rose 1%. That was partially offset by a 2% decline from Packaging & Specialty Plastics.

Pricing took a significant toll on the company's top line, however, as it declined 9% year-over-year. All segments saw pricing declines with the exception of Performance Materials & Coatings, which managed to come in flat in Q1. The decline in pricing was primarily due to the company's polyethylene, isocyanates, and hydrocarbon products. Currency translation also knocked 2% off of the top line.

Operating EBITDA was $1.9 billion during the quarter, down 24% from the year-ago period, but was in line with prior guidance. Margin compression from polyethylene, isocyanates and siloxanes as well as lower equity earnings more than offset some positive factors. Volume gains and cost synergy savings, as well as contributions from new capacity on the U.S. Gulf Coast weren't enough to offset lower margins in primary product categories.

Dow is on a path to achieve significant cost savings this year, as it achieved $125 million in savings in Q1 alone. Dow exited Q1 with a $1.365 billion annual cost synergy run-rate.

The company announced a $3 billion share repurchase program, good for ~9% of the float, and a quarterly dividend of 70 cents. Management stated it is committed to offering an industry-leading dividend to shareholders.

We're out with an initial estimate of $4.40 in earnings-per-share for this year, but note that given margin and pricing volatility, this estimate could change materially in the ensuing quarters.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	---	---	---	---	---	---	---	---	---	$3.99	***$4.40***	***$5.62***
DPS	---	---	---	---	---	---	---	---	---	---	***$2.80***	***$3.60***
Shares	---	---	---	---	---	---	---	---	---	747	***748***	***750***

We see Dow growing at an annual rate of 5% in the coming years as the outlook for its business is rather bright, but with the caveat that margins can be quite volatile.

Gains will accrue in the coming years from stabilized pricing, which management believes will improve in the second half of this year, margin gains from cost savings, and the company's robust share repurchase program. These factors combined should afford Dow the ability to produce at least mid-single digit earnings-per-share growth annually for the foreseeable future, with upside potential should pricing improve more than expected. We like the company's diverse product portfolio and it should see demand hold up in a variety of environments.

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The dividend was initiated at $2.80 annually, good for an enormous yield on today's share price. We see the dividend rising along with earnings per management's commitment to offer a best-in-class yield.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	---	---	---	---	---	---	---	---	---	*10.6*	*12.0*
Avg. Yld.	---	---	---	---	---	---	---	---	---	---	*6.0%*	*5.3%*

Since Dow just began trading on its own, there is no history to compare the current valuation to. However, given that Dow should grow in the mid-single digits or better in the coming years, in addition to how the parent company was valued before the spinoff, we see 12 times earnings as a reasonable price. That compares favorably to the current valuation of 10.6, implying an annual tailwind to total returns of 2.4%.

In addition, the yield is 6%, which is generally reserved for stocks like REITs or BDCs, so Dow is extremely attractive for income investors. We see the yield falling somewhat over time as the valuation creeps up.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	---	---	---	---	*64%*	*64%*

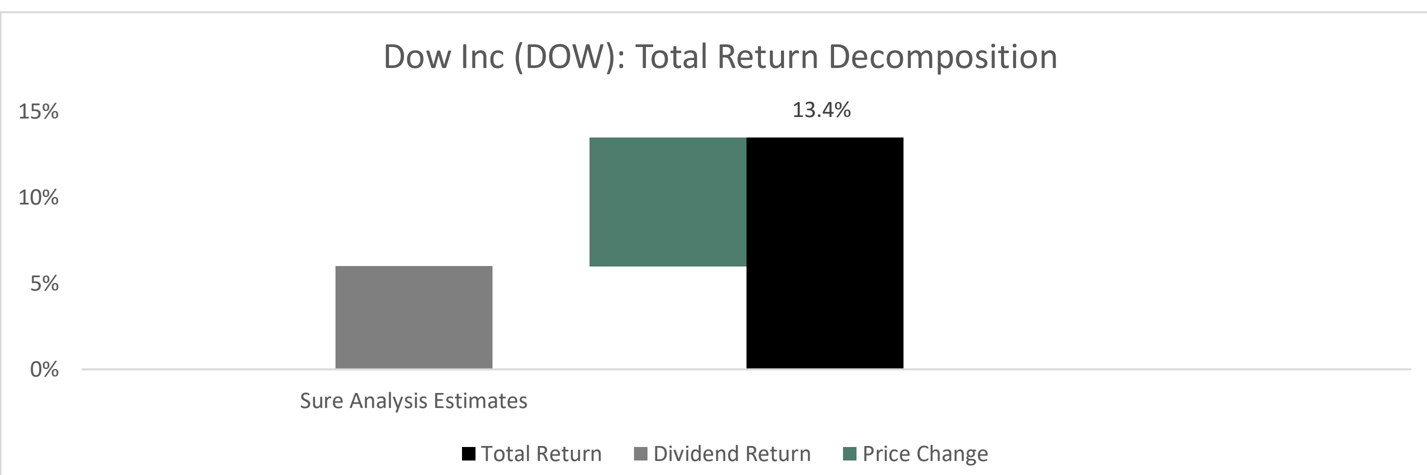
Dow's payout ratio is currently at around two-thirds of earnings, which is where we expect it to stay. The company's growth outlook is reasonably strong, meaning there shouldn't be any dividend safety issues, even if a recession strikes.

While we don't have any data to understand how Dow will perform in a recession, given that the business has only existed in its current form since April, we believe the company's product portfolio is not only its competitive advantage, but also should perform well enough during downturns to keep the company profitable and able to pay the dividend. We see the company's focused efforts on high-growth areas such as consumer care, packaging, and infrastructure, as well as its very long operating history as a component of the former company, and its brand, as competitive advantages.

Final Thoughts & Recommendation

We see Dow producing very strong 13.4% total returns in the coming years, consisting of the 6% yield, 5% earnings growth, and a 2.4% tailwind from a rising valuation. Dow represents a unique blend of value, growth, and a high yield that we find attractive. We rate Dow a buy after its spinoff from its former parent.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue								48158	55508	60278
Gross Profit								10490	11896	12573
Gross Margin								21.8%	21.4%	20.9%
SG&A Exp.								4066	3602	2846
D&A Exp.								2862	3155	3329
Operating Profit								4287	6022	7569
Operating Margin								8.9%	10.8%	12.6%
Net Profit								4318	466	4499
Net Margin								9.0%	0.8%	7.5%
Free Cash Flow								-6948	-8102	1336
Income Tax								9	2204	1285

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets									79940	77378
Cash & Equivalents									6188	2669
Accounts Receivable									7338	8246
Inventories									8376	9260
Goodwill & Int. Ass.									19487	18761
Total Liabilities									52931	49409
Accounts Payable									5360	5378
Long-Term Debt									21001	19899
Shareholder's Equity									25823	26831
D/E Ratio									0.81	0.74

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets										5.7%
Return on Equity										17.1%
ROIC										9.4%
Shares Out.								747	748	750
Revenue/Share								64.21	74.01	80.37
FCF/Share								-9.26	-10.80	1.78

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.