



Dow Inc. (DOW)

Updated September 11th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$46	5 Year CAGR Estimate:	6.5%	Volatility Percentile:	0.1%
Fair Value Price:	\$42	5 Year Growth Estimate:	3.0%	Momentum Percentile:	40.9%
% Fair Value:	110%	5 Year Valuation Multiple Estimate:	-1.9%	Growth Percentile:	17.2%
Dividend Yield:	6.0%	5 Year Price Target	\$49	Valuation Percentile:	43.4%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	44.1%

Overview & Current Events

Dow Inc. is a 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 \$44 billion in revenue this year and trades with a market capitalization of \$32 billion.

Dow reported Q2 earnings on 7/25/19 and results were weak, along with weak commentary from management that caused us to cut our estimates for this year. Revenue was off 14% year-over-year, falling to \$11 billion. This was primarily attributable to local price declines in polyethylene, siloxanes, and isocyanates, as well as lower volumes in hydrocarbon co-products. Dow has struggled for some time with pricing and volume for its products, and second quarter results show unequivocally that there is no respite in sight. Volume declined 3% year-over-year, exacerbating the company's pricing issues.

Operating profit was down sharply in Q2, and operating earnings declined year-over-year from \$1.41 per share to just \$0.86. Comparisons are very messy given Dow wasn't a standalone company last year, but no matter which way the numbers are viewed, they were poor for Q2.

The company cited "ongoing trade and geopolitical uncertainties" in cutting its capex budget by 20%, removing \$500 million from its original \$2.5 billion budget. Clearly, Dow sees material headwinds, or it wouldn't pull its growth funding. Given weak revenue and margin performance so far this year, we've cut our estimate of earnings-per-share from \$4.40 to just \$3.50. We see reduced capex as a sign that things may get worse before they get better for Dow, and there has been no progress on improving its basic fundamentals so far in 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	---	---	---	---	---	---	---	---	---	\$3.99	\$3.50	\$4.06
DPS	---	---	---	---	---	---	---	---	---	---	\$2.80	\$3.09
Shares¹	---	---	---	---	---	---	---	---	---	747	748	750

We've also cut our long-term growth estimate down from 5% to 3% given the revenue and margin issues the company is experiencing. Until Dow can show some level of volume and pricing improvement, growth will be challenged.

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 some measure of 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.

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.

¹ Share count in millions

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	---	---	---	---	---	---	---	---	---	13.2	12.0
Avg. Yld.	---	---	---	---	---	---	---	---	---	---	6.0%	6.3%

Since Dow just began trading on its own, there is no history in which to compare the current valuation. 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 unfavorably to the current valuation of 13.2, however, implying an annual headwind to total returns of ~2%.

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 remaining around 6% for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	---	---	---	---	80%	76%

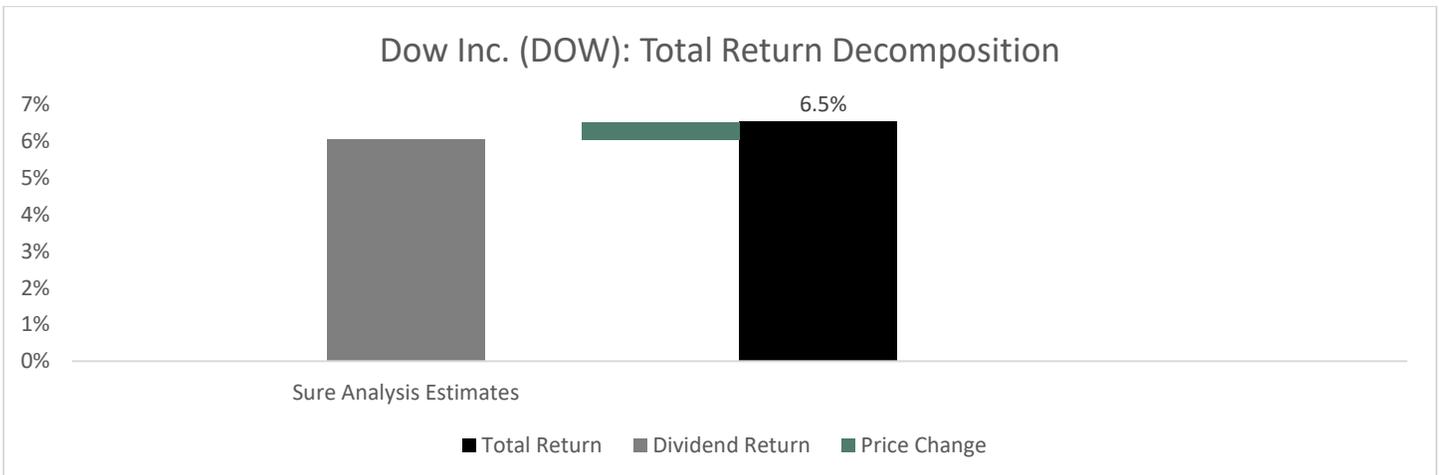
Dow's payout ratio is currently at 80% of earnings, which is where we expect it to stay. The reduced outlook for earnings growth has us a bit more cautious on Dow's dividend safety. We don't see any issues in the immediate future, but a deep recession could make it difficult for Dow to afford its ample payout.

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 under most circumstances. 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 6.5% total returns in the coming years, consisting almost entirely of the 6% yield, with the valuation and earnings growth nearly offsetting each other. As a result of the challenges mentioned, as well as much lower total projected returns, we're moving Dow from buy to hold.

Total Return Breakdown by Year



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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.

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