



Dow Inc. (DOW)

Updated November 3rd, 2019 by Josh Arnold

Key Metrics

Current Price:	\$52	5 Year CAGR Estimate:	4.0%	Volatility Percentile:	0.1%
Fair Value Price:	\$42	5 Year Growth Estimate:	3.0%	Momentum Percentile:	28.9%
% Fair Value:	125%	5 Year Valuation Multiple Estimate:	-4.3%	Growth Percentile:	17.5%
Dividend Yield:	5.4%	5 Year Price Target	\$49	Valuation Percentile:	21.0%
Dividend Risk Score:	F	Retirement Suitability Score:	D	Total Return Percentile:	22.3%

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 \$43 billion in revenue this year and trades with a market capitalization of \$39 billion.

Dow reported Q3 earnings on October 24th, beating expectations but missing comparables from last year by a fairly wide margin. Total revenue was \$1.08 billion, down 15% against pro forma results from last year's Q3. The decline was driven by weak local pricing, primarily attributable to declines in global energy prices. Indeed, local price plummeted 12% year-over-year on declines in polyethylene and hydrocarbon co-products. Volume was down 2% as well as demand growth in packaging, polyurethanes, and silicones was more than offset by lower hydrocarbon co-product sales.

Operating earnings before interest and taxes, or EBIT, declined from \$1.6 billion to \$1.1 billion year-over-year. Margin compression continues to be an issue for Dow thanks to lower volumes and even worse pricing. However, the company's robust cost synergies are helping to offset some of that weakness despite lower revenue. Indeed, against this year's Q2, EBIT margin was up 80bps, so progress is being made. Dow completed its prior \$1.365 billion cost synergy program that was in place prior to the spin-off during Q3. Dow returned \$600 million to shareholders in Q3, with dividends making up the vast majority of that at \$500 million.

Earnings-per-share came to \$0.91 on an adjusted basis, down from \$1.34 in the year-ago period. This decline was in line with our expectations, and we are therefore reiterating \$3.50 in earnings-per-share for this year.

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	743	720

We previously 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, and we continue to expect modest growth for the foreseeable future.

Gains will accrue in the coming years from stabilized pricing, which management believes will improve in the second half of this year and into 2020, 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 a high 5%+ 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	---	---	---	---	---	---	---	---	---	---	14.9	12.0
Avg. Yld.	---	---	---	---	---	---	---	---	---	---	5.4%	6.3%

Since Dow only recently began trading on its own, there is no history in which to compare the current valuation.

However, given that Dow should grow in the low-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 14.9, however, implying an annual headwind to total returns of ~4%.

In addition, the yield is 5.4%, which is generally reserved for stocks like REITs or BDCs, so Dow is extremely attractive for income investors. We see the yield remaining very high and actually climbing back to 6%+ in the coming years after a recent rally in the share price has meaningfully reduced the yield.

Safety, Quality, Competitive Advantage, & Recession Resiliency

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

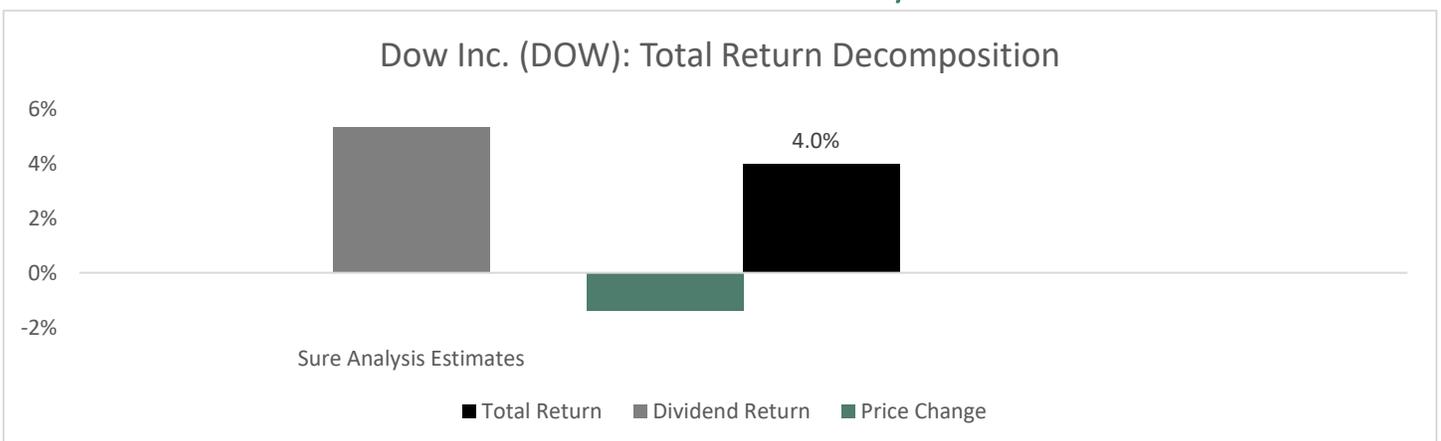
Dow's payout ratio is currently at 80% of earnings, which is where we expect it to stay. The reduced outlook for earnings growth has us a bit more cautious on Dow's dividend safety. We don't see any issues in the immediate future, but a deep recession could make it difficult for Dow to afford its ample 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 4% total returns in the coming years, consisting of the yield, with the valuation and earnings growth mostly offsetting each other. As a result of the challenges mentioned, as well as much lower total projected returns, we're moving Dow from hold to sell, the second downgrade in as many quarters.

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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