



Dow Inc. (DOW)

Updated February 4th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$47	5 Year CAGR Estimate:	6.6%	Market Cap:	\$34.2B
Fair Value Price:	\$43	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	02/27/20 ¹
% Fair Value:	110%	5 Year Valuation Multiple Estimate:	-1.8%	Dividend Payment Date:	03/13/20 ²
Dividend Yield:	6.0%	5 Year Price Target	\$49	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

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 \$34 billion.

Dow reported Q4 and full-year earnings on January 29th, and results beat expectations on both the top and bottom lines. Total revenue was \$10.2 billion for the quarter, down -15% year-over-year on a pro forma basis; Dow was still part of the old DowDuPont during Q4 of 2018, so comparisons are pro-forma. The company reported lower local pricing in all operating segments, which it attributed to the decline in energy prices. Volume also declined -2% year-over-year as lower hydrocarbon co-product sales offset gains made elsewhere, particularly in packaging and construction chemicals. Pricing fell -12% year-over-year and currency translation took a further -1% from the top line in Q4.

Operating EBIT was \$1.0 billion during Q4, down from \$1.3 billion in the comparable period of 2018. Margin compression and lower sales were contributing factors. The company also saved \$35 million in operating costs during the quarter as part of its efficiency initiatives, bringing the total to more than \$160 million for 2019.

Free cash flow came to \$1.3 billion after accounting for \$577 million in capex, and the company returned \$611 million to shareholders during the quarter. Dividends accounted for \$517 million, while the balance of \$94 million was spent on share repurchases.

We see 2020 earnings in line with 2019 as pricing and volumes remain volatile; our initial estimate is \$3.55 per share.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	---	---	---	---	---	---	---	\$3.99	\$3.49	\$3.55	\$4.12
DPS	---	---	---	---	---	---	---	---	---	\$2.10	\$2.80	\$3.09
Shares³	---	---	---	---	---	---	---	---	747	743	740	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 into 2020, margin gains from cost savings, and the company's 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.

¹ Estimated date

² Estimated date

³ 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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The dividend was initiated at \$2.80 annually, good for a ~6% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2024
Avg. P/E	---	---	---	---	---	---	---	---	---	14.4	13.2	12.0
Avg. Yld.	---	---	---	---	---	---	---	---	---	4.2%	6.0%	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 13.2, however, implying an annual headwind to total returns of just under -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 very high and actually climbing slightly in the coming years as the valuation declines, but the payout rises.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	---	---	---	---	60%	79%	75%

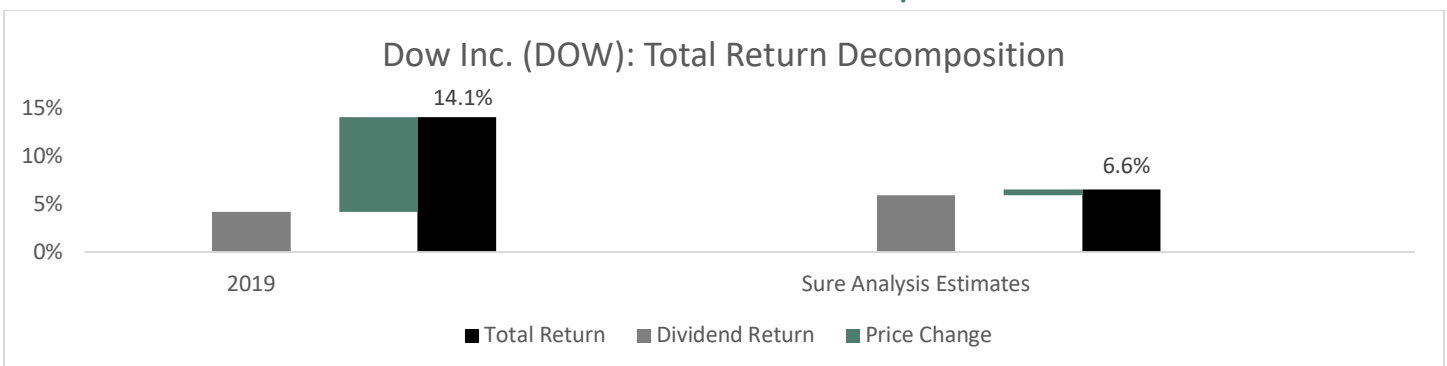
Dow's payout ratio is currently at 79% of earnings, which is about where we expect it to stay. The reduced outlook for earnings growth has us a bit more cautious on Dow's dividend safety. We don't see any issues in the immediate future, but a deep recession could make it difficult for Dow to afford its 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 of 2019, 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 6.6% total returns in the coming years, consisting of the ample yield, with the valuation partially offsetting projected earnings growth. However, with the valuation returning to a more favorable level, and projected total returns in excess of 6%, we are moving Dow up from sell to hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue							48,158	55,508	60,278	42,951
Gross Profit							10,490	11,896	12,573	6,294
Gross Margin							21.8%	21.4%	20.9%	14.7%
SG&A Exp.							4,066	3,602	2,846	1,590
D&A Exp.							2,862	3,155	3,329	2,938
Operating Profit							4,287	6,022	7,569	3,520
Operating Margin							8.9%	10.8%	12.6%	8.2%
Net Profit							4,318	466	4,499	-1,359
Net Margin							9.0%	0.8%	7.5%	-3.2%
Free Cash Flow							-6,948	-8,102	1,336	3,969
Income Tax							9	2,204	1,285	470

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets								79,940	77,378	60,524
Cash & Equivalents								6,188	2,669	2,367
Accounts Receivable								7,338	8,246	4,844
Inventories								8,376	9,260	6,214
Goodwill & Int. Ass.								19,487	18,761	12,555
Total Liabilities								52,931	49,409	46,430
Accounts Payable								5,360	5,378	3,889
Long-Term Debt								21,001	19,899	16,996
Shareholder's Equity								25,823	26,831	13,541
D/E Ratio								0.81	0.74	1.26

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets									5.7%	-2.0%
Return on Equity									17.1%	-6.7%
ROIC									9.4%	-3.4%
Shares Out.							747	748	747	743
Revenue/Share							64.21	74.01	80.37	57.85
FCF/Share							-9.26	-10.80	1.78	5.35

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

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