



# Dow Inc. (DOW)

Updated August 4<sup>th</sup>, 2020 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$40	<b>5 Year CAGR Estimate:</b>	1.8%	<b>Market Cap:</b>	\$29.7 B
<b>Fair Value Price:</b>	\$28	<b>5 Year Growth Estimate:</b>	3.0%	<b>Ex-Dividend Date:</b>	08/28/20 <sup>1</sup>
<b>% Fair Value:</b>	146%	<b>5 Year Valuation Multiple Estimate:</b>	-7.3%	<b>Dividend Payment Date:</b>	09/12/20 <sup>2</sup>
<b>Dividend Yield:</b>	7.0%	<b>5 Year Price Target</b>	\$32	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Last Dividend Increase:</b>	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 1<sup>st</sup>, 2019 with the ticker DOW. It should produce about \$36 billion in revenue this year and trades with a market capitalization of \$30 billion.

Dow reported second quarter earnings on July 23<sup>rd</sup>, with results coming in better than expected on the top line, but weaker than expected on adjusted profits. Adjusted earnings-per-share came to -\$0.26 as the company continues to grapple with plummeting demand for its products.

Total revenue was down -24% year-over-year to \$8.4 billion, driven by local price and volume declines, as well as volume declines from COVID-19-related weakness. Local price was down -14% in the quarter, while forex translation crimped the top line by another -1%. Volume was down -9% against the year-ago period thanks to weakness in durable good end-markets globally. Dow noted it posted a 13% sequential improvement in volume in Asia-Pacific, attributable to the reopened Chinese economy.

Free cash flow came to \$1.3 billion in Q2, up \$836 million year-over-year, with \$516 million of that being sent to shareholders via dividends. Debt was down \$600 million in Q2, ending the quarter at \$12 billion.

We've cut our earnings-per-share estimate for this year essentially in half, and it now sits at just 75 cents. In addition, we've cut our earnings power estimate – which normalizes results for COVID-19 – to \$2.50. We see continued weakness in results and the outlook commentary from management as concerning for the company's long-term earnings power.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	---	---	---	---	---	---	---	---	\$3.99	\$3.49	<b>\$0.75</b>	<b>\$2.90</b>
<b>DPS</b>	---	---	---	---	---	---	---	---	---	\$2.10	<b>\$2.80</b>	<b>\$2.17</b>
<b>Shares<sup>3</sup></b>	---	---	---	---	---	---	---	---	747	743	<b>740</b>	<b>720</b>

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 can accrue in the coming years from stabilized pricing, which management believes will improve into 2021, 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

<sup>1</sup> Estimated date

<sup>2</sup> Estimated date

<sup>3</sup> 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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hold up in a variety of environments. We note that 2020 is a negative outlier due to collapsing demand in many of Dow's markets, but this should abate as the world's economy returns to normal over time.

The dividend was initiated at \$2.80 annually, good for a ~7% yield on today's share price. However, given the protracted weakness in earnings, we're cutting our dividend forecast to a 2025 value of \$2.17 per share.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2024
Avg. P/E	---	---	---	---	---	---	---	---	---	14.4	<b>16.0</b>	<b>11.0</b>
Avg. Yld.	---	---	---	---	---	---	---	---	---	4.2%	<b>7.0%</b>	<b>6.8%</b>

With earnings temporarily depressed this year, we're using a normalized earnings power value of \$2.50 to compute fair value and valuation metrics. Since Dow only recently began trading on its own, there is no history in which to compare the current valuation. We see 11 times earnings as a reasonable valuation. That compares very unfavorably to the current valuation of 16 times earnings power, implying an annual headwind to total returns of about 7%.

In addition, the yield is 7%, 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 in the coming years.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	---	---	---	---	60%	<b>112%</b>	<b>75%</b>

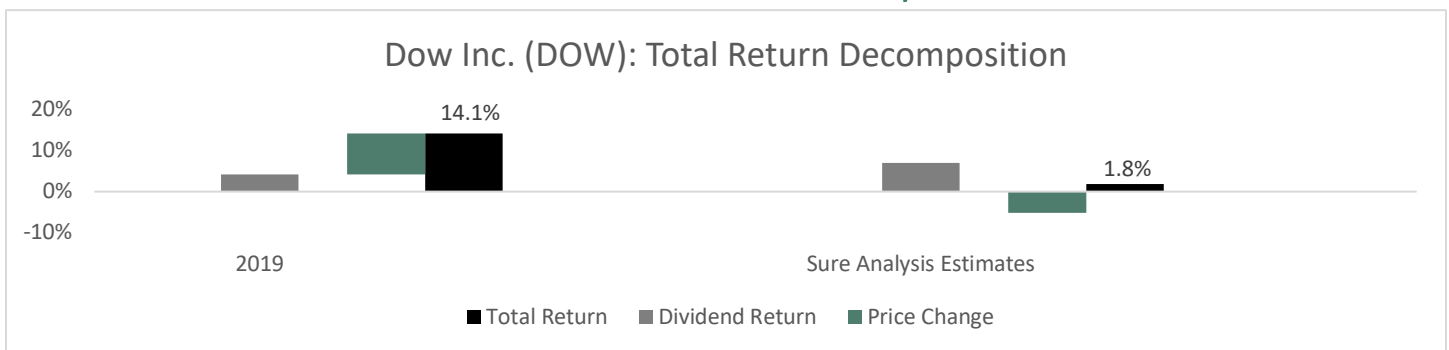
Dow's payout ratio is currently at 112% of earnings power, which has us cautious on the dividend moving forward. We think Dow will need to cut the payout at some point in the foreseeable future given the weak earnings outlook.

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. 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. That said, 2020 is going to be very rough.

## Final Thoughts & Recommendation

We see Dow producing just 1.8% total returns in the coming years, consisting of the ample yield, but with the valuation contracting. Dow's earnings outlook has deteriorated significantly since our last update, and we're moving the stock to a sell rating. We don't see the dividend as safe, and we see shares as overpriced.

## 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.

### Disclaimer

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