



Dow Inc. (DOW)

Updated February 1st, 2021 by Josh Arnold

Key Metrics

Current Price:	\$52	5 Year CAGR Estimate:	4.7%	Market Cap:	\$39 B
Fair Value Price:	\$42	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	02/27/21 ¹
% Fair Value:	123%	5 Year Valuation Multiple Estimate:	-4.1%	Dividend Payment Date:	03/11/21 ²
Dividend Yield:	5.4%	5 Year Price Target	\$51	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	D	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 \$39 billion.

Dow reported fourth quarter and full-year earnings on January 28th, 2021 with results coming in better than expectations. Total revenue was up 5% year-over-year to \$10.7 billion, as prices, volume, and currency translation were all tailwinds. Local price was up 2% year-over-year, currency added 2%, and volume added the balance of 1% to the top line. Dow noted it continues to recover nicely from pandemic headwinds.

Equity earnings were \$106 million in Q4, up from a loss of -\$21 million in the same period a year ago, driven by massive improvements in the Sadara joint venture. Dow noted it completed the sale of certain Gulf coast marine and terminal operations and assets, generating \$620 million in cash proceeds during Q4.

Net debt was reduced by \$837 million in the quarter, which helped in reducing debt by \$2.6 billion in 2020.

Adjusted earnings-per-share came to \$0.81, which excludes gains on the sale of the marine and terminal operations sold during the quarter. Operating EBIT was \$1.1 billion, up from \$1.0 billion in the year-ago period.

Our initial estimate for 2021 is \$3.25 in earnings-per-share as Dow is upbeat about its outlook.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	---	---	---	---	---	---	---	\$3.99	\$3.49	\$1.66	\$3.25	\$3.95
DPS	---	---	---	---	---	---	---	---	\$2.10	\$2.80	\$2.80	\$2.80
Shares³	---	---	---	---	---	---	---	747	743	745	715	600

We have reduced our earnings growth estimate slightly, from 5% to 4%, as Dow's base of earnings is much higher for 2021. We also note that earnings growth for Dow and its predecessor companies has generally been a challenge, even under good conditions.

Gains can accrue in the coming years from stabilized pricing, which management believes will continue to 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 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. Indeed, Q4 showed improvement in the company's results.

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 5.4% yield on today's share price. However, given the protracted weakness in earnings, we believe the dividend will remain flat for the foreseeable future.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	---	---	---	---	---	---	---	---	14.4	26.5	16.0	13.0
Avg. Yld.	---	---	---	---	---	---	---	---	4.2%	6.4%	5.4%	5.4%

Since Dow only recently began trading on its own, there is no history in which to compare the current valuation. We see 13 times earnings as a reasonable valuation. That compares very unfavorably to the current valuation of 16 times earnings, implying a sizable headwind to total annual returns. We see the recent move up in the share price as overdone given very volatile earnings. On the other hand, the 5.4% yield is quite attractive for income investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	---	---	---	---	---	---	60%	169%	86%	71%

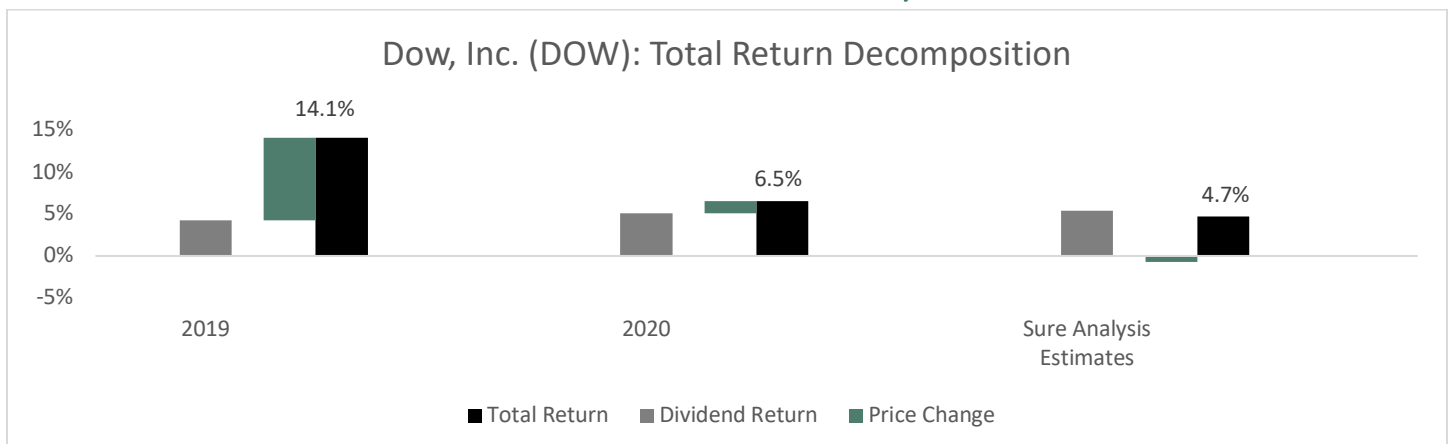
Dow's payout ratio is currently at 86% of estimated earnings, which has us cautious on the dividend moving forward. We think dividend raises will be tough to come by in the coming years, even with earnings beginning to move higher.

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 was rough and the recovery may take a year or two, but Dow remained profitable.

Final Thoughts & Recommendation

We see Dow producing just 4.7% total returns in the coming years, consisting of the ample yield, but with the valuation contracting. Dow's earnings outlook has improved since our last update, and we're moving the stock from sell to hold. We don't see the dividend as particularly safe, and we see shares as overpriced, particularly given the uncertainty around the company's recovery in earnings. The safety of the dividend appears to have improved with the 2021 outlook however, which is good enough for a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	---	---	---	---	---	48,158	55,508	60,278	42,951	38,542
Gross Profit	---	---	---	---	---	10,490	11,896	12,573	6,294	5,196
Gross Margin	---	---	---	---	---	21.8%	21.4%	20.9%	14.7%	13.5%
SG&A Exp.	---	---	---	---	---	4,066	3,602	2,846	1,590	1,471
D&A Exp.	---	---	---	---	---	2,862	3,155	3,329	2,938	2,874
Operating Profit	---	---	---	---	---	4,287	6,022	7,569	3,520	2,556
Operating Margin	---	---	---	---	---	8.9%	10.8%	12.6%	8.2%	6.6%
Net Profit	---	---	---	---	---	4,318	466	4,499	-1,359	1,225
Net Margin	---	---	---	---	---	9.0%	0.8%	7.5%	-3.2%	3.2%
Free Cash Flow	---	---	---	---	---	-6,948	-8,102	1,336	3,969	4,839
Income Tax	---	---	---	---	---	9	2,204	1,285	470	777

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	---	---	---	---	---	---	79,940	77,378	60,524	61,470
Cash & Equivalents	---	---	---	---	---	---	6,188	2,669	2,367	5,104
Accounts Receivable	---	---	---	---	---	---	7,338	8,246	4,844	4,839
Inventories	---	---	---	---	---	---	8,376	9,260	6,214	5,701
Goodwill & Int. Ass.	---	---	---	---	---	---	19,487	18,761	12,555	12,260
Total Liabilities	---	---	---	---	---	---	52,931	49,409	46,430	48,465
Accounts Payable	---	---	---	---	---	---	5,360	5,378	3,889	3,763
Long-Term Debt	---	---	---	---	---	---	21,001	19,899	16,996	17,107
Shareholder's Equity	---	---	---	---	---	---	25,823	26,831	13,541	12,435
D/E Ratio	---	---	---	---	---	---	0.81	0.74	1.26	1.38

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	---	---	---	---	---	---	---	5.7%	-2.0%	2.0%
Return on Equity	---	---	---	---	---	---	---	17.1%	-6.7%	9.4%
ROIC	---	---	---	---	---	---	---	9.4%	-3.4%	4.0%
Shares Out.	---	---	---	---	---	747	748	747	743	745
Revenue/Share	---	---	---	---	---	64.21	74.01	80.37	57.85	51.92
FCF/Share	---	---	---	---	---	-9.26	-10.80	1.78	5.35	6.52

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

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