



Dow Inc. (DOW)

Updated October 25th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$47	5 Year CAGR Estimate:	9.6%	Market Cap:	\$33 B
Fair Value Price:	\$70	5 Year Growth Estimate:	-3.0%	Ex-Dividend Date:	11/27/22 ¹
% Fair Value:	67%	5 Year Valuation Multiple Estimate:	8.4%	Dividend Payment Date:	12/10/22
Dividend Yield:	6.0%	5 Year Price Target	\$60	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Dow Inc. is a standalone company that was 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 \$57 billion in revenue this year and trades with a market capitalization of \$33 billion.

Dow released third quarter earnings on October 20th, 2022, and results were mixed. Adjusted earnings-per-share came to \$1.11, which was four cents lower than expected. Revenue was down 5% year-over-year to \$14.1 billion, but beat estimates by \$1.1 billion.

Revenue was down 5% year-over-year in the largest segment, Packaging and Specialty Plastics, as pricing gains in polymers were more than offset by lower polyethylene prices, and reduced demand for packaging in Europe. Industrial Intermediates & Infrastructure revenue was 9% lower, due primarily to pricing declines and higher currency translation costs. Performance Materials & Coatings was +5% year-over-year as local pricing gains more than offset declining demand.

Gross margin plummeted from 21.7% of revenue a year ago to 12.3% in Q3. Dow is working on cost savings to help offset some of this, as energy costs continue to weigh on the company's profitability.

Net income was \$760 million, or \$1.02 per share, which was down sharply from \$1.71 billion, or \$2.23 per share, in the year-ago period.

We now see \$6.40 in earnings-per-share for this year.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	---	---	---	---	---	---	\$3.99	\$3.49	\$1.66	\$8.98	\$6.40	\$5.50
DPS	---	---	---	---	---	---	---	\$2.10	\$2.80	\$2.80	\$2.80	\$2.80
Shares²	---	---	---	---	---	---	747	743	745	735	718	650

We expect -3% earnings growth as Dow's base of earnings is lower for 2022, down from an expected 0% growth rate. We also note that earnings growth for Dow and its predecessor companies has generally been a challenge, even under good conditions. With enormous pricing power helping drive results in 2021, we see it as very likely that 2021 marks a top in earnings for the foreseeable future.

Gains can accrue in the coming years from stabilized pricing, which improved immensely in 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 under normalized conditions, but we see normalized pricing as offsetting these factors in 2022 and beyond. 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,

¹ Estimated date

² Share count in millions

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but this should abate as the world's economy returns to normal over time. In reversing the losses suffered in 2020, 2021 is likely to prove an outlier as well, with mean reversion to follow.

The dividend is \$2.80 annually, good for a 6% yield on today's share price.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	---	---	---	---	---	---	---	14.4	26.5	6.8	7.3	11.0
Avg. Yld.	---	---	---	---	---	---	---	4.2%	6.4%	4.6%	6.0%	4.6%

Since Dow only recently began trading on its own, there is only a short history in which to compare the current valuation. We see 11 times earnings as a reasonable valuation. That compares very favorably to the current valuation of 7.3 times earnings, which implies the stock is still quite undervalued. However, we note that expectations are currently for lower earnings for 2022, so the stock isn't quite as cheap as it was given lower estimates. The yield is now 6%, so the stock's appeal as an income stock remains very strong.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	---	---	---	---	---	---	---	60%	169%	31%	44%	51%

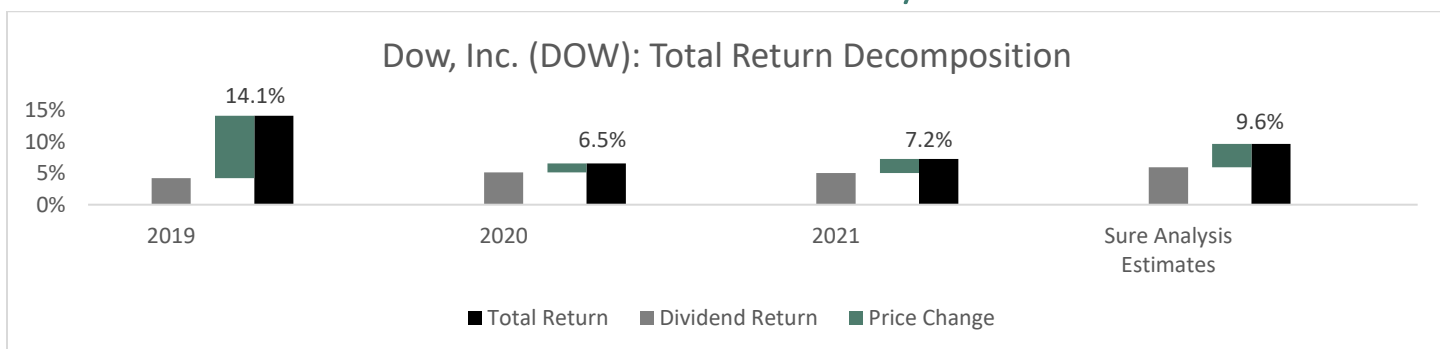
Dow's payout ratio is currently at 44% of estimated earnings. We think dividend raises will be tough to come by in the coming years, even as earnings are forecast to be quite strong this year. Given the strong yield, management doesn't appear to be interested in raising the payout at the moment, and is instead focusing on boosting the buyback allocation, particularly with low valuations.

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.

Final Thoughts & Recommendation

We forecast Dow producing 9.6% annualized total returns in the coming years, consisting of the 6% yield, but a 3% contraction in earnings, helped by an 8.4% tailwind from the valuation. Given this, we're downgrading the stock from buy to hold. The safety of the dividend appears to remain quite good for 2022. However, we are very cautious on the company's ability to grow earnings from extremely high levels in 2021, and our projected total returns are reliant upon the valuation moving higher over time.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	---	---	---	---	48,158	55,508	60,278	42,951	38,542	54,968
Gross Profit	---	---	---	---	10,490	11,896	12,573	6,294	5,196	10,777
Gross Margin	---	---	---	---	21.8%	21.4%	20.9%	14.7%	13.5%	19.6%
SG&A Exp.	---	---	---	---	4,066	3,602	2,846	1,590	1,471	1,645
D&A Exp.	---	---	---	---	2,862	3,155	3,329	2,938	2,874	2,842
Operating Profit	---	---	---	---	4,287	6,022	7,569	3,520	2,556	7,887
Operating Margin	---	---	---	---	8.9%	10.8%	12.6%	8.2%	6.6%	14.3%
Net Profit	---	---	---	---	4,318	466	4,499	-1,359	1,225	6,311
Net Margin	---	---	---	---	9.0%	0.8%	7.5%	-3.2%	3.2%	11.5%
Free Cash Flow	---	---	---	---	-6,948	-8,102	1,336	3,969	4,839	4,685
Income Tax	---	---	---	---	9	2,204	1,285	470	777	1,740

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	---	---	---	---	---	79,940	77,378	60,524	61,470	62,990
Cash & Equivalents	---	---	---	---	---	6,188	2,669	2,367	5,104	2,988
Accounts Receivable	---	---	---	---	---	7,338	8,246	4,844	4,839	6,841
Inventories	---	---	---	---	---	8,376	9,260	6,214	5,701	7,372
Goodwill & Int. Ass.	---	---	---	---	---	19,487	18,761	12,555	12,260	11,645
Total Liabilities	---	---	---	---	---	52,931	49,409	46,430	48,465	44,251
Accounts Payable	---	---	---	---	---	5,360	5,378	3,889	3,763	5,577
Long-Term Debt	---	---	---	---	---	21,001	19,899	16,996	17,107	14,672
Shareholder's Equity	---	---	---	---	---	25,823	26,831	13,541	12,435	18,165
LTD/E Ratio	---	---	---	---	---	0.81	0.74	1.26	1.38	0.81

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	---	---	---	---	---	---	5.7%	-2.0%	2.0%	10.1%
Return on Equity	---	---	---	---	---	---	17.1%	-6.7%	9.4%	41.2%
ROIC	---	---	---	---	---	---	9.4%	-3.4%	4.0%	19.9%
Shares Out.	---	---	---	---	747	748	747	743	745	735
Revenue/Share	---	---	---	---	64.21	74.01	80.37	57.85	51.92	73.39
FCF/Share	---	---	---	---	-9.26	-10.80	1.78	5.35	6.52	6.26

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

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