



Dow Inc. (DOW)

Updated July 26th, 2023, by Josh Arnold

Key Metrics

Current Price:	\$53	5 Year CAGR Estimate:	1.3%	Market Cap:	\$38 B
Fair Value Price:	\$24	5 Year Growth Estimate:	12.0%	Ex-Dividend Date:	08/28/23 ¹
% Fair Value:	219%	5 Year Valuation Multiple Estimate:	-14.5%	Dividend Payment Date:	06/10/23
Dividend Yield:	5.3%	5 Year Price Target	\$43	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	D	Rating:	Sell

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 \$44 billion in revenue this year and trades with a market capitalization of \$38 billion.

Dow posted second quarter earnings on July 25th, 2023, and results were better than expected on both the top and bottom lines. However, expectations leading up to the report had been drastically reduced, so the earnings beat doesn't mean Dow's results are necessarily strong on an absolute basis.

Adjusted earnings-per-share came to 75 cents, which was four cents ahead of estimates. Revenue plunged 27% year-over-year to \$11.4 billion, but did beat expectations by \$140 million. Volume fell 8% year-over-year, but was 1% higher from Q1. Local price fell 18% year-over-year and 5% from Q1, as Dow posted declines in all operating segments due to lower demand and input costs.

Operating earnings before interest and taxes was \$885 million, only about a third of the \$2.4 billion from the year-ago period, as all segments declined. Free cash flow conversion was 98% on a trailing-twelve-months basis.

Dow's management team noted they continue to focus on cost saving actions to help boost margins, but that the team expects conditions to remain "challenging" throughout the second half of the year. Cost savings are on track for about \$1 billion in 2023. We've slashed our estimate of earnings-per-share to \$2.20 for this year on plummeting revenue and margins, noting we believe there will be a sharp rebound possible in 2024.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	---	---	---	---	---	\$3.99	\$3.49	\$1.66	\$8.98	\$6.25	\$2.20	\$3.88
DPS	---	---	---	---	---	---	\$2.10	\$2.80	\$2.80	\$2.80	\$2.80	\$2.80
Shares²	---	---	---	---	---	747	743	745	735	705	700	600

We expect 12% earnings growth as Dow's base of earnings is very low for 2023. 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. This is particularly true given results in 2023 thus far, as pricing has become a headwind instead of a tailwind.

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. We are cautious on guidance for 2023 as Dow is exhibiting its characteristic extreme earnings volatility.

The dividend is \$2.80 annually, good for a 5.3% yield on today's share price.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	---	---	---	---	---	---	14.4	26.5	6.8	8.1	24.1	11.0
Avg. Yld.	---	---	---	---	---	---	4.2%	6.4%	4.6%	5.6%	5.3%	6.6%

Since Dow only fairly 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 unfavorably to the current valuation of 24.1 times earnings, which implies the stock is still quite overvalued. This is the product of a decline in earnings estimates, primarily. The yield is now 5.3%, so the stock's appeal as an income stock remains very strong, nonetheless.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	---	---	---	---	---	60%	169%	31%	45%	127%	72%

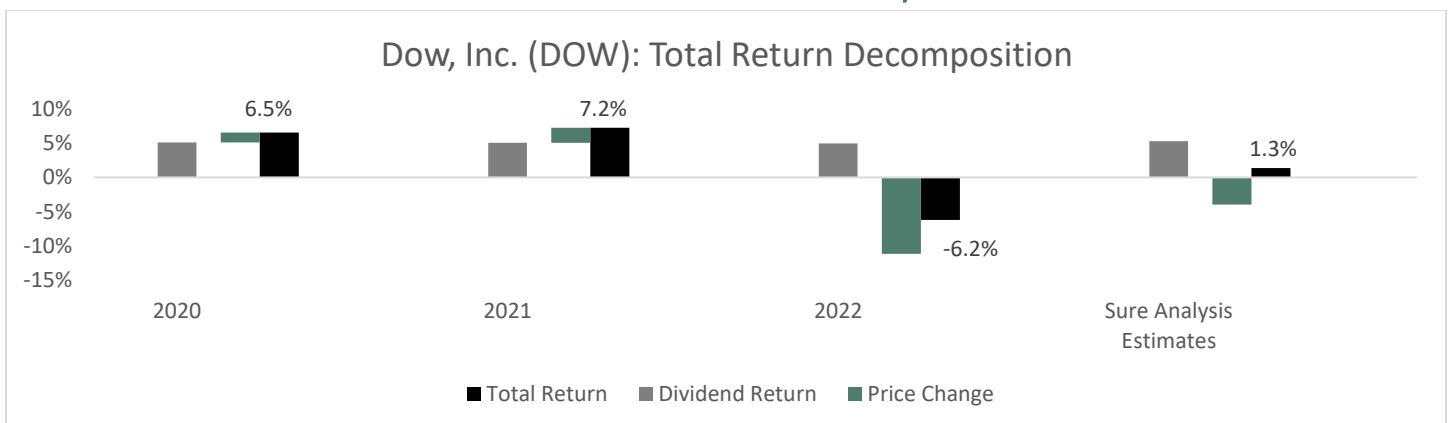
Dow's payout ratio is currently at 127% of estimated earnings. We think dividend raises will be tough to come by in the coming years. Given the strong yield, management doesn't appear to be interested in raising the payout at the moment, and is instead focusing on boosting the buyback allocation.

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 1.3% annualized total returns in the coming years, consisting of the 5.3% yield, a 12% expansion in earnings from the very low base, offset by a 14.5% headwind from the valuation. Given this, we're reiterating the stock at a sell rating. The safety of the dividend appears to be okay for 2023 given strong free cash flow conversion. However, we are cautious on the company's ability to grow earnings going forward given massive earnings volatility.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	---	---	---	48,158	55,508	60,278	42,951	38,542	54,968	56,902
Gross Profit	---	---	---	10,490	11,896	12,573	6,294	5,196	10,777	8,564
Gross Margin	---	---	---	21.8%	21.4%	20.9%	14.7%	13.5%	19.6%	15.1%
SG&A Exp.	---	---	---	4,066	3,602	2,846	1,590	1,471	1,645	1,675
D&A Exp.	---	---	---	2,862	3,155	3,329	2,938	2,874	2,842	2,758
Operating Profit	---	---	---	4,287	6,022	7,569	3,520	2,556	7,887	5,702
Operating Margin	---	---	---	8.9%	10.8%	12.6%	8.2%	6.6%	14.3%	10.0%
Net Profit	---	---	---	4,318	466	4,499	-1,359	1,225	6,311	4,582
Net Margin	---	---	---	9.0%	0.8%	7.5%	-3.2%	3.2%	11.5%	8.1%
Free Cash Flow	---	---	---	-6,948	-8,102	1,336	3,969	4,839	4,685	5,417
Income Tax	---	---	---	9	2,204	1,285	470	777	1,740	1,450

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	---	---	---	---	79,940	77,378	60,524	61,470	62,990	60,603
Cash & Equivalents	---	---	---	---	6,188	2,669	2,367	5,104	2,988	3,886
Accounts Receivable	---	---	---	---	7,338	8,246	4,844	4,839	6,841	5,611
Inventories	---	---	---	---	8,376	9,260	6,214	5,701	7,372	6,988
Goodwill & Int. Ass.	---	---	---	---	19,487	18,761	12,555	12,260	11,645	11,086
Total Liabilities	---	---	---	---	52,931	49,409	46,430	48,465	44,251	39,356
Accounts Payable	---	---	---	---	5,360	5,378	3,889	3,763	5,577	4,940
Long-Term Debt	---	---	---	---	21,001	19,899	16,996	17,107	14,672	15,422
Shareholder's Equity	---	---	---	---	25,823	26,831	13,541	12,435	18,165	20,718
LTD/E Ratio	---	---	---	---	0.81	0.74	1.26	1.38	0.81	0.74

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	---	---	---	---	---	5.7%	-2.0%	2.0%	10.1%	7.4%
Return on Equity	---	---	---	---	---	17.1%	-6.7%	9.4%	41.2%	23.6%
ROIC	---	---	---	---	---	9.4%	-3.4%	4.0%	19.9%	13.2%
Shares Out.	---	---	---	747	748	747	743	745	735	726
Revenue/Share	---	---	---	64.21	74.01	80.37	57.85	51.92	73.39	78.42
FCF/Share	---	---	---	-9.26	-10.80	1.78	5.35	6.52	6.26	7.47

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

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