THOMSON REUTERS

EDITED TRANSCRIPT

Q2 2019 Dow Inc Earnings Call

EVENT DATE/TIME: JULY 25, 2019 / 12:00PM GMT

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

CORPORATE PARTICIPANTS

Howard I. Ungerleider *Dow Inc. - President & CFO*
James R. Fitterling *Dow Inc. - CEO & Director*
Neal Sheorey *Dow Inc. - VP of IR*

CONFERENCE CALL PARTICIPANTS

Aleksey V. Yefremov *Nomura Securities Co. Ltd., Research Division - Research Analyst*
Christopher S. Parkinson *Crédit Suisse AG, Research Division - Director of Equity Research*
David L. Begleiter *Deutsche Bank AG, Research Division - MD and Senior Research Analyst*
Dylan Scott Carter Campbell *Goldman Sachs Group Inc., Research Division - Research Analyst*
Frank Joseph Mitsch *Fermium Research, LLC - Senior MD*
Hassan Ijaz Ahmed *Alembic Global Advisors - Partner & Head of Research*
Jeffrey John Zekauskas *JP Morgan Chase & Co, Research Division - Senior Analyst*
John Ezekiel E. Roberts *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*
John Patrick McNulty *BMO Capital Markets Equity Research - Analyst*
Jonas I. Oxgaard *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*
Kevin William McCarthy *Vertical Research Partners, LLC - Partner*
P.J. Juvekar *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*
Steve Byrne *BofA Merrill Lynch, Research Division - Director of Equity Research*
Vincent Stephen Andrews *Morgan Stanley, Research Division - MD*

PRESENTATION

Operator

Good day, and welcome to the Dow Second Quarter 2019 Earnings Call. (Operator Instructions) Also, today's call is being recorded. I would now like to turn the call over to Mr. Neal Sheorey. Please go ahead, sir.

Neal Sheorey ***Dow Inc. - VP of IR***

Good morning, everyone. Thank you for joining us to discuss the second quarter financial results for Dow. We're making this call available via webcast, and we have prepared slides to supplement our comments during this conference call. They are posted on the Investor Relations section of Dow's website and through the link to our webcast.

Speaking on the call today are Jim Fitterling, Dow's Chief Executive Officer; and Howard Ungerleider, President and Chief Financial Officer.

Please read the forward-looking statement disclaimer contained in the earnings news release and slides. During our call, we will make forward-looking statements regarding our expectations or predictions about the future. Because these statements are based on current assumptions and factors that involve risks and uncertainties, our actual performance and results may differ materially from our forward-looking statements. Dow's Form 10 as well as our Forms 10-Q and 10-K include detailed discussions of principal risks and uncertainties which may cause such differences.

Unless otherwise specified, all historical financial measures presented today are on a pro forma basis. And all financials, where applicable, exclude significant items. We'll also refer to non-GAAP measures. A reconciliation to the most directly comparable GAAP financial measure and other associated disclosures are contained in the Dow earnings release, in the slides that supplement our comments today and on the Dow website.

On Slide 2, you'll see our agenda for the call. Jim will start with an overview of Dow's second quarter performance and highlights. Howard will then move into a financial overview of the quarter and will also provide some comments on modeling guidance. Jim will then cover the results for each of our operating segments, and we'll close with a discussion on our forward-looking view. Following that, there would be plenty of time for your questions.

With that, I'll turn the ball over to Jim.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

James R. Fitterling ***Dow Inc. - CEO & Director***

Thanks, Neal, and thanks, everyone, for joining us this morning.

Starting on Slide 3. Our performance in the second quarter reflected the benefits of Dow's streamlined and more focused portfolio and our disciplined operational and financial management. It was a quarter that proved to be more challenging than many of us in the industry expected, and you've heard this from many of our peers in the past few weeks. In spite of this, the Dow team was able to deliver top and bottom line results that were in line with our guidance and consensus estimates. And despite the macro and end market volatility, we achieved core earnings growth sequentially when adjusting for our previously communicated higher planned turnaround spending in the quarter.

Our second quarter results were enabled by proactive and deliberate action. First, we captured demand growth in select consumer markets where the conditions have remained strong. For example, we grew volume in plastic packaging applications both sequentially and year-over-year, supported by our new capacity on the U.S. Gulf Coast. And in our polyurethane systems business, we grew our volume year-over-year for the 24th consecutive quarter.

Second, we made full use of our industry-leading feedstock flexibility. Favorable NGL feedstock trends helped us expand operating EBITDA margin in the P&SP segment as we utilized our ethane flexibility in the U.S. and our LPG capabilities in Europe.

Third, we continued to drive expense management. In addition to reduced discretionary spending, we delivered more than $175 million savings from cost synergies and stranded cost removal. You can see this traction in our numbers. In the second quarter alone, we drove $75 million of year-over-year savings in our combined SG&A and R&D. We've now delivered more than $1.1 billion of cumulative cost synergy savings since merger close and remain well on track to deliver the $600 million of synergy and stranded cost savings that we targeted this year.

Fourth, we quickly put in place actions to further tighten our capital spending in the quarter. Not only was the second quarter CapEx spending below last year, but our first half spending was below trend relative to our full year target. We are taking additional actions to reduce Capex, which I'll cover later in the call.

And fifth, we continued our focus on cash as we generated higher cash flow from operating activities and improved our cash conversion in the quarter. Part of our improvement was driven by a decrease in integration and separation cost outlays, which will continue to be a tailwind going forward. We remain on track to reduce this cash spending by $200 million to $400 million versus 2018.

Taken together, this is a solid result by the Dow team, and it underscores our ability to adapt as market conditions evolve. Going forward, we will continue to take prudent actions to manage near-term macroeconomic challenges while preserving our long-term competitive advantages. I'll share more about our plans in my closing remarks.

I'll now turn it over to Howard to discuss our overall financial performance and modeling guidance.

Howard I. Ungerleider ***Dow Inc. - President & CFO***

Thanks, Jim.

Turning to Slide 4. Net sales were $11 billion, in line with our guidance. The decline was driven primarily by lower local pricing in polyethylene, siloxanes and isocyanates as well as lower sales of hydrocarbon co-products due to lighter feedslates in both the U.S. and Europe. Volume declined 3% year-over-year driven primarily by lower hydrocarbon co-product sales due to higher internal ethylene consumption from the startup of new downstream assets and our cracker feedstock selection. A notable volume highlight is our growth in the Packaging & Specialty Plastics business, which was up 3% year-over-year.

Local price was down 9%, and currency decreased sales 2% primarily driven by a stronger U.S. dollar against the euro. Equity losses were $15 million primarily driven by margin compression in MEG and polyethylene at the Kuwait joint ventures as well as margin compression

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

in isocyanates at Sadara.

Operating EBIT for the quarter was $1.1 billion, and EPS was $0.86, in line with consensus estimates. The key earnings tailwinds in the quarter were volume gains in packaging applications, PU systems and isocyanates, contributions from new capacity in the U.S. Gulf Coast and savings from cost synergies and stranded cost removal. These gains were more than offset by margin compression in our key value chains which impacted both our core business results and our JV equity earnings.

Turning to our cash metrics. We generated nearly $1 billion of cash flow from operating activities in the quarter, an increase of $200 million year-over-year. And we also continued to improve our EBITDA to cash flow from operations conversion, which rose to more than 50%.

And finally, we returned $800 million to our owners in the quarter including $500 million of paid dividends and $300 million of share repurchases. As you may recall, we set a target of $500 million of share repurchases for the year, and we remain on pace to achieve that.

Now let's look at our principal joint ventures on Slide 5. Equity losses for the quarter were $15 million primarily driven by margin compression in MEG and polyethylene at the Kuwait joint ventures, reduced cracker and polyethylene margins at our Thai JVs and margin compression in isocyanates at the Sadara joint venture.

With regard to Sadara, as we have discussed before, one of the key items we are working on is receiving certification for passing the lender reliability test, the key milestone required for the JV parent to be released from the guarantees of Sadara's debt financing. The process to receive the certification typically takes 6 to 9 months, and we're progressing on that timeline. We have made good progress thus far and have essentially isolated the last gating item to a logistics services agreement. We are in active discussions with our partner, the JV and the lending syndicate to resolve this issue. Based on the progress to date, we are on track to formally receive certification in the second half of this year.

Moving to Slide 6 and our modeling guidance for the third quarter. As usual, we are providing specific guidance for our top line revenue expectations as well as several items below the EBIT line. With regard to segment expectations, we are providing our guidance on a sequential basis in response to investor feedback and to reflect the most relevant comparison in today's environment.

At the total Dow level, we expect EBIT tailwinds sequentially including more than $40 million from cost synergy savings and stranded cost removal as well as more than $50 million of lower planned maintenance spending as these costs peaked in the second quarter. However, these gains are temporarily offset by a couple of third-party outages that are impacting our operations in the third quarter.

In Performance Materials & Coatings, we see siloxanes pricing in the third quarter remaining about at the same level as we exited the second quarter, which means that third quarter average pricing will be down sequentially. On the positive side, our formulated silicones demand and margins continue to hold up very well, showcasing the resiliency in our differentiated businesses that are closer to the consumer.

Moving to the Industrial Intermediates and Infrastructure segment. From a pricing perspective, current forecasts estimate MDI prices to trend relatively flat with the second quarter levels. And MEG prices, on average, are projected to soften on a sequential basis. As such, we expect equity earnings results to be lower than the second quarter due to these factors. Additionally, Sadara's operations are being negatively impacted by the reliability of a third-party industrial gas supplier which is limiting production in JV's polyurethane chain. The supplier is actively addressing the issues, and the JV currently expects to ramp to normal operations by the middle of the quarter. Sadara currently estimates this limitation to have a $20 million impact to Dow's equity earnings in the quarter.

And finally, in the Packaging & Specialty Plastics segment, we expect robust packaging demand to continue. We see feedstock price trends continuing to drive lighter cracker feedslates in the U.S. and Europe which will further reduce our top line sales of co-products. From an industry supply-demand perspective, new ethylene capacity that is expected to come online in the U.S. will likely put some upward pressure on the ethane prices. The segment will be impacted by a planned cracker maintenance turnaround in the Netherlands as well as an issue that we're dealing with in Argentina.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Late in the second quarter, there was a significant countrywide power outage in Argentina which also spread to neighboring countries. The power outage abruptly shut down our ethylene operations. We have teams on the ground assessing the damage and beginning repairs. And our best estimate today is that the facility will be offline for at least the entire third quarter and is expected to have approximately $100 million impact on our results.

I'll now turn it back to Jim to cover the performance in our segments as well as our near-term outlook.

James R. Fitterling ***Dow Inc. - CEO & Director***

Thanks, Howard.

On Slide 7, Performance Materials & Coatings operating EBIT was $214 million, down 27% from the year ago period primarily driven by siloxane's margin compression, higher planned turnaround spending and Performance Monomers shipping restrictions from our Deer Park, Texas location due to a tank farm fire at a third-party facility, which we highlighted in our modeling guidance on the last earnings call.

Consumer Solutions sales declined as price and volume gains in the U.S. and Canada were more than offset by price declines in Asia Pacific and EMEAI and volume declines in EMEAI and Latin America. The decline year-over-year primarily reflects lower demand in automotive and consumer electronics end markets.

Coatings & Performance Monomers sales declined primarily due to lower volumes and local price. In addition to the Performance Monomers' shipping restrictions in Deer Park, the business was also impacted by wet weather that drove a delay in seasonal demand for coatings application in the United States and Europe.

On Slide 8, Industrial Intermediates & Infrastructure operating EBIT was $154 million, down from the year ago period due to local price and volume declines and margin compressions in isocyanates and MEG that impacted both our core business and joint venture results. Polyurethanes & Construction Chemicals sales declined on lower isocyanates pricing and currency headwinds in Europe. Volume gains in isocyanates and systems applications were offset by declines in polyols, propylene oxide and propylene glycol.

Industrial Solutions reported lower sales due to declines in local volume and price. Demand and growth in Asia Pacific and Latin America was more than offset by volume declines in the U.S. and Canada and EMEAI driven by softer demand in agriculture, automotive and electronics end markets as well as reduced supply due to planned maintenance turnaround. Equity losses for the segment were $78 million driven by margin compression at the Kuwait and Sadara joint ventures.

On Slide 9. Operating EBITDA for the Packaging & Specialty Plastics segment was $768 million, down 17% from the year ago period. Margin compression in polyethylene products and reduced equity earnings more than offset demand growth for packaging applications, benefits from new capacity on the U.S. Gulf Coast and cost synergy savings. Equity earnings for the segment were $74 million, down from the year-ago period based on lower earnings from the Kuwait joint ventures.

The Packaging & Specialty Plastics business reported lower net sales due to reduced polyethylene product prices and currency headwinds. However, the business achieved 3% volume growth led by a double-digit gain in Asia Pacific and increases in EMEAI. From an end market perspective, growth was led by industrial and consumer packaging and health and hygiene applications.

And in Hydrocarbons & Energy, sales declined on both lower volume and local price. The volume decline was primarily driven by increased internal ethylene consumption and our feedstock selection as well as a planned turnaround in Germany which led to a further reduction in hydrocarbon co-product sales.

Let's now turn to Slide 10, where I'll close with our near-term outlook. In light of the current market dynamics, we're taking several actions to continue to manage the operational levers within our control. First, the macro environment is cautious largely driven by geopolitical volatility and prolonged trade negotiations which continue today. The net result is the continuation of a short-term buying

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

pattern and decreased visibility along value chain. Bottom line, today, we still see the global economy expanding, but the pace of growth is slower particularly in Europe and in China. The U.S. remains fairly robust in consumer nondurable sectors. However, spending on big-ticket items like home builds, autos, durable goods and consumer electronics remains tepid globally. And we're closely watching consumer confidence measures which showed some softness during the second quarter.

Second, pricing in our intermediates are expected to continue to move sideways in the near term as a result of the business environment. You will recall that prices dropped in the fourth quarter of 2018 on a rapid destocking across our product chain plus a sharp decline in oil. Prices settled in the first quarter of 2019, and we saw a positive signs going into the second quarter, but those trends reversed as macro uncertainties escalated. While we're not counting on any immediate trade resolutions, we are still of the view that a path forward on that front can be a catalyst for improved market sentiment and a return to more normalized supply chains and buying patterns.

Third, feedstock trends have improved. Since our last earnings call, ethane prices in the U.S. continued to decline, and today, the forward curve has moved lower. We believe that ethane prices could rise modestly going forward as frac spreads are near 0 today. And we expect new ethylene demand coming online. But we continue to see a much more subdued price trajectory and a much lower probability of any ethane spike.

In Europe, LPG continues to be favored versus naphtha. This is important for Dow as we have industry-leading LPG flexibility in Europe with the capability to produce up to 60% of our ethylene from LPG. And as you would expect, throughout the second quarter and today, we have been utilizing this flexibility. In short, these feedstock trends play to Dow's flexibility strength, and they represent another operational lever that we continue to manage closely as we see opportunities.

Turning to Slide 11. Against this backdrop of macro and market trends, we have a clear execution plan moving forward. First, we will continue to leverage the strengths of our business model, and that includes benefiting from our feedstock flexibility, continuing to manage our margins and pushing for pricing recovery.

Second, we will keep prioritizing cost control. We have more cost synergy savings and stranded cost removal to accomplish, and we have a clear line of sight to get to it. We will also keep a tight lid on discretionary spending.

Third, with the softness we see in our intermediates pricing, we need to continue selling up and optimizing our product wheel. That means staying focused on driving more captive use of our intermediates into higher value add products such as coatings and silicones formulations and PU systems.

And finally, on our investments, we are reducing our 2019 CapEx target from $2.5 billion to $2 billion. This is the prudent action to take as it gives us time to slow down some investments that require more market visibility while maintaining our asset base, improving reliability and preserving our ability to invest in quick win, incremental expansions to deliver value growth even in the current business environment.

In our view, this is not the time to invest in a major greenfield project. Here are a few examples of the actions that we are taking. We have decided to postpone the advancement of our feasibility study for a new world-scale siloxanes plant as we have more near-term value creating, de-bottleneck opportunities to pursue. Building on that point, we continue to greenlight incremental de-bottlenecks in our silicones franchise. Year-to-date, we have completed 5 of the 18 downstream silicones capacity expansions that we have on deck for 2019. We recently agreed to acquire our partner's stake in our Thai HPPO joint venture for a net cash outlay of approximately $150 million. This transaction is expected to close later this year and will be immediately accretive to our ROIC.

After a detailed analysis of project returns and future demand growth, we have decided to postpone our planned 450,000-ton polyolefins expansion in Europe.

And we will continue to push forward select process innovation especially those that move us down the cost curve, reduced capital intensity and lower greenhouse gas emissions. This is something in Dow's wheelhouse. Catalyst and process technology developments have historically represented hallmark investments for Dow and the industry. These near-term actions reflect our financial discipline and

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

returns-oriented mindset. And they preserve the advantages that serve us well over the longer term. Our purpose-built portfolio and leading business positions, our leaner cost structure and our suite of incremental high return growth investments, these factors will continue to differentiate Dow and drive our earnings growth trajectory.

In closing, we delivered a solid second quarter results in a tough environment. Going forward, you can continue to count on the Dow team to remain focused on driving a leaner cost structure, running our assets efficiently, optimizing the value of our integration, growing our differentiated positions and continuing to be disciplined capital and resource allocators.

Now I'll turn it back to Neal to open the Q&A.

Neal Sheorey ***Dow Inc. - VP of IR***

Thank you, Jim. With that, let's move on to your questions. I would like to remind you that our forward-looking statements apply to both our prepared remarks and the following Q&A. Operator, please provide the Q&A instructions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today will come from Vincent Andrews with Morgan Stanley.

Vincent Stephen Andrews ***Morgan Stanley, Research Division - MD***

Wondering if you could just sort of give us an update on where your views are on polyethylene supply and demand sort of not just for the back half of this year but maybe into 2020 and 2021. There seems to be a lot of debate out there, again, over exactly how much supply is going to come not just in the U.S. but also in the rest of the world, whether China or parts of Eastern Europe. So your updated thoughts there would be very helpful.

James R. Fitterling ***Dow Inc. - CEO & Director***

Vince, yes, on polyethylene, operating rates and supply-demand balances, our view is that we've kind of been in a plateau here of about 87%, 88% operating rates in polyethylene globally. And I think we're going to continue to see that extend out over the next couple of years. Mainly, we went back and took a look at what's happened with projections on capacity adds since back to 2007. And when you look at that whole track record of what's reported versus what actually happened, there were 64 projects that were supposed to start up in 2019 or beyond. Only 18 of those could be tied back to that original forecast. And 13 of the 18 were supposed to come online already, and every single 1 of them has been pushed back from its original start date. So I think some of these projections, whether it's about ethane prices spiking at the back half of the year or whether it's about plummeting operating rates, are a little bit tough to understand. The market's growth is there. We had good growth in the quarter. We had double-digit growth in China both in polyethylene and in downstream silicones. So the market demand growth is there. And I think that the biggest issue really in the integrated chain has to do more with the ethylene supply-demand balances, and that's because everybody in the U.S. has been integrating and so that merge in ethylene has driven some of the margin out of the U.S. ethylene integrated margins.

Operator

And next, we move to David Begleiter with Deutsche Bank.

David L. Begleiter ***Deutsche Bank AG, Research Division - MD and Senior Research Analyst***

Jim, Howard, just on the Q3 guidance, looking at Slide 6, you called out headwinds of roughly $270 million, tailwinds of $90 million, so I guess a net $180 million headwind. What other headwinds, tailwinds do you see from the base business in Q3 versus Q2?

James R. Fitterling ***Dow Inc. - CEO & Director***

I'll take a shot and then ask Howard to comment because I think there are 2 sides on this thing. I think you've got the headwinds and tailwinds in there. I mean, we see pricing moving sideways basically in the third quarter. I would say with 1 exception, I expect siloxanes in Asia Pacific, because of where we ended the quarter, that would have been an averaging effect in the third quarter. So that may have a little bit of downward pressure on siloxanes. The rest of silicones is holding up well. And the headwinds part is really heavily influenced

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

by Argentina and the issues that Howard mentioned on the quote. So obviously, we're going to do everything we can to try to get back as soon as we can, but still, it's going to be the quarter to make those repairs, and our estimate there is $100 million.

Howard, any other on the financial side that you've got?

Howard I. Ungerleider ***Dow Inc. - President & CFO***

Yes. David, I would say just when you look at that slide, it's pretty balanced between the headwinds and the tailwinds. So you referenced and Jim talked about the $100 million in Argentina and the $20 million I talked about on the call in the prepared remarks on Sadara. And you got $90 million of lower turnarounds -- lower planned turnaround spending sequentially and the cost synergies coming out. So minus $90 million plus $120 million, it's kind of a balanced approach.

James R. Fitterling ***Dow Inc. - CEO & Director***

And then we had an increase in cash from operating activities in the quarter, so that was up $200 million year-over-year. And we continue to come off of those integration expenses. We've got a lot of integration projects and separation projects, actually, that wind up third quarter, fourth quarter. So that sets us up nice for 2020. And we expect the year-over-year decline in those separation costs of about $1 billion next year.

Operator

And next we'll move on to Jeff Zekauskas from JPMorgan.

Jeffrey John Zekauskas ***JP Morgan Chase & Co, Research Division - Senior Analyst***

Some consultants think that polyethylene prices in June were down $0.03 a pound because of unofficial discounts. And other consultants think that prices were flat. Which do you think is the more accurate representation of the June domestic polyethylene market? And then secondly, CP Chem is buying Nova Chemical. Did you guys bid for that?

James R. Fitterling ***Dow Inc. - CEO & Director***

Jeff, our view on polyethylene prices is they were flat in June. And I expect they'll continue to move sideways here into the third quarter.

Regarding Nova, our only discussions with Nova obviously are around settling the issue we've got with them over that the E3 cracker, so we had no other discussions with them.

Operator

And next we'll move to Christopher Parkinson with Crédit Suisse.

Christopher S. Parkinson ***Crédit Suisse AG, Research Division - Director of Equity Research***

When you return your comments last year regarding the flat margin benefits in isocyanates, siloxanes, et cetera, that would act as '19 headwinds, can you quickly revisit your quantitative assumptions in this calculations and just give us an update on where we stand today given the initial magnitude? Just any thoughts would be helpful.

James R. Fitterling ***Dow Inc. - CEO & Director***

Yes. At the time, we saw a step-down obviously in China based on new capacity that came on in China in the siloxanes area. And so we saw that move down. And our view obviously is we were going to continue to invest downstream to convert more of our own siloxanes than into finished materials. It's a little bit worse than we had forecasted at the time, and it's lasted a little bit longer than we had expected. But otherwise, everything else is on track. And the growth on the downstream silicones is on track. We had double-digit growth in China in the quarter. We had good growth around the world. So you see consumer markets like health and beauty care, you see large commercial, residential -- or large commercial buildings like skyscrapers and things, those continue to move forward. Some softness obviously in applications that go into electronics and auto. But all else remains on track.

Operator

And we'll move on to P.J. Juvekar with Citi.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

P.J. Juvekar ***Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD***

Can you talk about your feedstock slate into the crackers? You talked about ethane supply-demand. But looks like butane was the cheapest feedstock by almost $0.06 compared to ethane on a COE basis. So how much butane can you push into the crackers in the Gulf Coast?

And then secondly, on polyethylene, we have had destocking since second half of last year. So where do you think inventories stand today relative to normal? And if you can address U.S. and China there, that would be great.

James R. Fitterling ***Dow Inc. - CEO & Director***

Yes. So butane was the cheapest, and we maxed as much butane as we could. In fact, in the quarter, we brought on a butane vaporizer in Louisiana to help us increase the amount of butane that we can put in there. So we continue to look at places where we can do that. It's a function of both how much butane can you get at a location and then how much can you vaporize to move into the cracker. So we'll continue to do that.

The other big move, obviously, recently, has been propane. So propane-naphtha spreads have widened. And we've been cracking some propane in the fleet as well, propane, ethane. Ethane had been favored most the second quarter, but just here recently, propane actually moved into the money, so we moved in a little bit there. Look, all the investments we've made over the last 5 years were not just growth oriented, they were also to expand our NGL capability and expand our flexibility, and that's paying off. And the propane trend that I mentioned really has a big impact on Europe. So we've been back to maxing LPG cracking in Europe for most of the year.

I would say I think the rest of the balance is on destocking, inventories are coming down, working capital is coming down. I think people are being a little bit more hand to mouth in their purchases. People are not being very speculative. And so we see that. I don't think that there's been any dramatic increase in any inventories in any part of the world.

Operator

And next we'll move to John McNulty with BMO Capital Markets.

John Patrick McNulty ***BMO Capital Markets Equity Research - Analyst***

So Jim, I mean it looks like the macro is certainly moderating. Maybe we're not in the global recession yet, but I guess how do you think about stress testing your model around cash flows and earnings if we do slip into some sort of a recession at this point given the pressures you've already been facing?

James R. Fitterling ***Dow Inc. - CEO & Director***

Right. Let me just talk about the market macros first, and then I'll have Howard then make a few comments on stress testing because it will tie back to what we talked about on last call about the work that we did on setting up the new Dow. I think the market is really kind of 2 different markets right now. So if you look at it geographically, China and Europe are having some big pressure right now more so than the U.S. So the U.S. economy is holding up relatively better. However, if you look at it from a market standpoint, automotive is down from last year. Last year was obviously a peak year for global light vehicle production, and we are down in those forecasts have continued to be revised down for the year. That has a lot of direct impact, but then it has an awful lot of indirect impact on content that hits our industry. Electronics are down, so it's the seventh consecutive month we've seen a contraction in new orders for electronics. That hasn't been that way since 2012. Home builds, the sentiment around Architectural Billing Index (sic) [Architecture Billings Index] is down about 400 basis points year-over-year. And durable goods have been down 3 of the last 4 months. And to me, this is the confidence factor in the market. And we typically see when people are concerned about the outlook, individual consumers, they tighten up on big-ticket purchases, and so that's reflected. The consumer nondurable side, health and beauty care, packaging purchases, things that people do every day, go out to eat, these kind of things, those numbers -- retail numbers are looking pretty good. And packaging silicone formulations, coatings formulations, PU systems, that's holding up pretty well. So I don't think we're in a recession. It doesn't feel like we're in a recession. I do think a trade resolution would bring some confidence back into people and brighten the outlook. And confidence is huge in these markets.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Howard, may be just a little recon on cash and the focus on cash which we did this quarter to make sure that we are generating good operating activity cash flow.

Howard I. Ungerleider ***Dow Inc. - President & CFO***

You bet. I would say on cash flow, our cash from operating activities was up $200 million even though earnings were down versus a year ago. On an apples-to-apples basis, you have to adjust for the AR securitization, and on apples-to-apples basis, it was flat. So we generated flat cash from ops. Even though earnings were down, we generated almost $1 billion of cash flow from operating activities.

To your stress test point, if you just -- look, if you take the first half based on your moderating point, John, you take the first half EBITDA and then annualize it, you're looking at about a $7.5 billion annual run rate. You subtract out interest and taxes of about $1.5 billion, you're at $6 billion. You heard the guidance that Jim gave on the call of lowering CapEx from $2.5 billion to $2 billion, so now you're at $4 billion. We guided to $1 billion of integration and separation costs this year because of the separation and the spinout from DowDuPont. Most of that spending now in the first half is behind us. So that will sequentially be a tailwind. That's $1 billion for the year, so subtract that from the $4 billion, you're talking about $3 billion of discretionary cash for dividends, share buyback, other things. That doesn't include any benefit from nonoperating cash. That doesn't include any benefit from working capital improvements. I'm pretty proud of the Dow team, the focus on cash inside the company is very, very high and we'll be continuing to drive that cash flow conversion number up. So we feel really good about that going forward.

Operator

And next we'll move to Bob Koort with Goldman Sachs.

Dylan Scott Carter Campbell ***Goldman Sachs Group Inc., Research Division - Research Analyst***

This is Dylan Campbell on for Bob. Could you help on ethane costs? It seems like sentiment and demeanor in ethane market has shifted pretty considerably since prices spiked above $0.60 a gallon last year and have fallen pretty considerably since then. Can you help diagnose and maybe just give us a little bit more context on why you don't think prices spike in the back half of the year? Can you give a little bit kind of a diagnosis of what has occurred over the last year or so?

James R. Fitterling ***Dow Inc. - CEO & Director***

Sure. I think at a high level, Dylan, it delays in new cracker startups. And then some on-time and early startups of new fractionators. And what that did is obviously drove a change in what the forward outlook would be on that ethane curve. There is excess U.S. ethane supply throughout the period from now until 2023. So the balance is going to be long, and I think that hasn't changed. New cracker delays have taken that ethane down -- ethane demand down by about 275,000 barrels per day. So that means the inventories got bloated, and you saw frac spreads go -- they actually went negative at the end of the quarter. They are back to breakeven or maybe slightly positive. And honestly, I think they could stay here to maybe $1 frac spread in this near-term period. And a little bit will depend on the timing and success of some of these cracker startups. You've got good oil production out of the Permian, the Eagle Ford, the SCOOP, the STACK. Those are really close to Mont Belvieu. You've got 1.2 million barrels a day of new wide grade pipelines. They're going to feed Mont Belvieu by first quarter of '20. And then 6 new Gulf Coast fractionators have been announced for startup in early 2020, and those have a combined capacity of 800,000 barrels per day. 450,000 of that is purity ethane. So that's what's led to the situation that you've got here. Gas demand is going to be at -- gas inventories are going to be at a 5-year high -- or 5-year average at the end of this year. We haven't been there for the last couple of years. I think our view is we are going to see these kind of prices for ethane for the near term here.

Operator

And next we'll hear from Jonas Oxgaard with Bernstein.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Jonas I. Oxgaard ***Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst***

Though the disconnect between U.S. domestic PE price and export price is now at a, I think, like a four-year high. And historically, these disconnects never last. But as export price is pretty much exactly in line with Asia price, the only correction that looks plausible is for U.S. domestic to come down. Can you give a little bit of color on why it has stayed so high for -- or the disconnect stayed so large for so long and how do you see that evolving?

James R. Fitterling ***Dow Inc. - CEO & Director***

Jonas, I think everybody had anticipated that with tariffs it would really shut off the whole China market. We haven't seen that. The demand for product in China has been strong. We were up double digits into China in the quarter. And I would also say you've got growth in other parts of the world which are sizable as well. So Southeast Asia, obviously coming. There's Africa. So I think there's enough market demand around the world that it hasn't forced that to happen. There are also some just built-in logistics hurdles here in the U.S. It's very much a railcar market, and so there's a delta that has to be maintained there and is protected there. But overall, I haven't seen that pressure on that. I think we've seen more pressure really on the ethylene market price on the integrated margins. And I think that's where we are going to continue to see that pressure until we see the derivative capacity and the links in the ethylene market really get back in line.

Operator

And moving on, we'll hear from Hassan Ahmed with Alembic Global.

Hassan Ijaz Ahmed ***Alembic Global Advisors - Partner & Head of Research***

Jim, it seems that the glycol market continues to be pressured, right? And as I take a look at sort of a bunch of moving parts over there, obviously, polyester, a big sort of end user, so I would imagine the whole China trade war side of things is playing a role. But just beyond that, it seems inventories in China are quite high for glycol, and there is incremental supply coming online. So how are you guys thinking about sort of the near to medium term side of things within glycol? I mean is it a situation which will quickly get resolved if there is a trade war resolution, or are there sort of fundamental near-term issues there?

James R. Fitterling ***Dow Inc. - CEO & Director***

I think you're right, Hassan, that glycol pricing relative to last year is down almost as much as the drop we saw in oil price in the fourth quarter, about 35%, 40%. They have been pretty stable at these levels for quite a while. There is inventory in China obviously that the traders are trying to work down. You've seen some rate cuts at some of the higher cost manufacturers trying to dial down really to get their operating rates to balance demand. Polyester is running pretty well in China. So I haven't seen like a big demand drop on polyester in China. I think those operating rates are good. But I do think if trade came off, you would see some of the producers there be a little bit more aggressive. And some of the retailers here, specifically here in the U.S., would probably be a little bit more open to purchases and not looking to shift their supply positions to other countries away from China.

Operator

Laurence Alexander with Jefferies will have our next question.

Unidentified Analyst

This is [Nick Cicera] on for Laurence. Just a quick follow-up comment on -- question on the MEG inventory. I was wondering how long it would take maybe to work down some of those levels in China.

James R. Fitterling ***Dow Inc. - CEO & Director***

That's a good question, Nick. Typically, we see these kind of corrections in MEG would typically take, under a strong growth format, maybe a quarter to work through. And I think you'll see some of these traders under pressure to get this -- from a cash flow standpoint, to get this worked out by the end of the year. So I think that's why people have been making adjustments on operating rates to try to balance things out. I would be surprised if they would want to carry these inventories through the year-end.

Operator

And next we'll hear from Frank Mitsch with Fermium Research.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Frank Joseph Mitsch ***Fermium Research, LLC - Senior MD***

Jim, in your discussions about pricing, you indicated that you thought third quarter would really see flat sort of pricing although you did have a concern on siloxanes. But I look at Slide 10, and we see that IHS is forecasting MDI prices to move up through the quarter. And so I'm curious as to what your outlook is on MDI. Do you agree with that notion that MDI should be moving up? What is your outlook there?

James R. Fitterling ***Dow Inc. - CEO & Director***

Frank, I think some of these forecasts on pricing are really tough as you go out into the future. MDI has been stable at these prices. Even MEG being low, it's been stable at these prices. Siloxanes, I would expect maybe somewhere we thought that they might tick up a little bit, but they've been pretty stable as well. I would think for MDI to move up, you're either going to have to have some turnaround outages or you are going to have to see a real pull on the demand side of the equation to make that happen. Our outlook for them is flat. And I would just also say the forecast that we had on these ethane prices that they were going to go up dramatically at the end of the year, and we were not -- at that time, we were saying we don't see that happening. And as we sit here today, it didn't happen. So I just think in this macro environment, it feels like third quarter's going to be kind of a sideways quarter like second quarter.

Operator

And we'll move on to Kevin McCarthy with Vertical Research Partners.

Kevin William McCarthy ***Vertical Research Partners, LLC - Partner***

Jim, I was wondering if you can compare and contrast what you're seeing in the polyurethane business and intermediates versus systems. And then on Slide 11, I think you have a comment about driving greater internal consumption of intermediates. Is that a reference to polyurethanes? Maybe if you could just provide a brief update on the strategy to go further downstream there as well.

James R. Fitterling ***Dow Inc. - CEO & Director***

Sure. Thanks, Kevin. Let me just touch the last one first. I think the biggest impact on internal consumption of our intermediates is really ethylene to polyethylene, ethylene to EO derivatives. We had historically been that short, buying material. And as we've back integrated and take advantage of shale gas, we're using more of that for our own downstream consumption. So the reason we highlighted that on the release and in the speaking comments that Howard made is because that typically would have been trade sales of ethylene or some other product to the market, and so the revenue line can look lighter even though our downstream sales are good. And it's just an adjustment in those numbers.

On polyurethanes, I think the biggest impact right now has been on automotive. So in automotive, seating and different parts that go into the auto industry, as those light vehicle builds have slowed down, that's kind of backed up some of that change.

Now systems going into things like spray foams, systems going into cold chain, refrigerated containers, going into insulation production for panels for especially commercial and big residential and commercial projects, that continues to look pretty good. And anything we can do into the adhesive space with the exception of obviously adhesives into automotive, which gets a little bit slowed down, has been pretty good. There are PU sales into appliances, so as those durable goods have slowed down, for example, in refrigerators and maybe in some panels for dishwashers and things, you will see a little bit of an impact there. I think that's the biggest impact on polyurethane. We'll continue to move more of those intermediates to downstream systems because we can work with the end-use customers to make finished products that really give them an advantage in their products and ability to capture higher value. And that's what we want to do long term, whether that's coatings, taking monomers into coatings or taking polyurethane intermediates into systems or taking more of our plastics into higher grade materials for packaging, health and hygiene, siloxanes into silicones, that's a consistent strategy. We're going to continue to do that across the board.

Operator

And we'll move on to Steve Byrne with Bank of America.

Steve Byrne ***BofA Merrill Lynch, Research Division - Director of Equity Research***

What's Dow headcount right now versus a year ago? And given these macro headwinds, have you reassessed opportunities to cut fixed costs? And similarly, what ability do you have with your joint ventures to push more aggressive cost cutting given the near-term outlook?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

James R. Fitterling ***Dow Inc. - CEO & Director***

Right. So our target headcount for the new Dow, once we completed all of our streamlining -- and really to do this, we had done external benchmarking with the best of the best. Our idea was to be best in class competitive, was to get to a headcount of 37,000 globally. And we will be there at the end of this year. In fact, we've accelerated some of those moves that we've planned through the year. We've accelerated some of those. And so that's why you see cost synergy savings coming out in advance of what we've said. We always continue to take a look at that. Headcount is part of our fixed cost, but it is only a fraction of it. So when you get to the number of sites that we have around the world, you also have to look at contractual relationships, services and other things that we do. So there's a heavy emphasis right now in manufacturing, engineering and all of that. Peter Holicki and his team are obviously looking at what does the future Dow need to look like in terms of footprint. And where we have opportunities to consolidate we are doing that.

And then the rest of this $600 million of savings we got to come out through this year is really getting after footprint consolidation, I would say, outside of manufacturing into things like getting lab consolidations done, which we've done a lot of this year, for example, in Europe and here in North America, office buildings and other things. So we are making good progress on that, and we keep doing that. We were fortunate that we were already in this mode coming out of the spin so that we have the machine moving. And we could go in at the beginning of the second quarter and say this is going to be a tough quarter. We got to keep the pressure on. So we did put some incremental targets in front of them. And then on top of that, we're going to put the CapEx numbers down there. And we'll get them down to $2 billion this year. And if it gets worse, I don't expect it's going to get recessionary, but if it gets into that kind of frame, we still have room to move.

Operator

And we'll move to John Roberts with UBS.

John Ezekiel E. Roberts ***UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals***

I think I heard you talk about discontinuing a European polyethylene project. But didn't you also have a 2022 start-up in the Gulf Coast planned? And is that still on track?

James R. Fitterling ***Dow Inc. - CEO & Director***

Yes, we did, John. Thanks for the question. We had a plant in Europe to take advantage of the link we had in ethylene there in and we had a plant in the U.S. Gulf Coast. What the business has done is gone and relooked at both of those projects. I think they do want to continue to pursue a U.S. Gulf Coast project because of the cost position that we have here. And they've decided to defer the one that's in Europe. And I would say postpone is the right answer. I think at some point in the future, it might make sense, but given all the things going on right now and the market outlook, it's probably not the right time to do that.

Operator

And next we'll move to Aleksey Yefremov.

Aleksey V. Yefremov ***Nomura Securities Co. Ltd., Research Division - Research Analyst***

Jim, thanks for the color on CapEx. Would you consider keeping CapEx close to $2 billion in 2020 if demand and margins do not improve?

James R. Fitterling ***Dow Inc. - CEO & Director***

I'm going to keep it tight until I get better visibility on the market. I think we need to get a trade deal resolved to get some confidence back in this market, at least on the current industrial side of things, right. I think the consumer is still strong. But on this industrial side of the market segment, and you've seen reports coming out from some big heavy equipment industrials that are also slowing down. We need -- those are high content uses for our materials. We need to see some pickup there. When we see some pickup there, then we'll take a look at what is the right time to move back in.

Meanwhile, those silicones projects, we have a couple of EO derivatives projects that are underway right now. This $150 million to buy back the other half of the Thai HPPO joint venture, these are high return projects and immediately accretive. So we're going to do -- I don't want to postpone those. Those are right in the sweet spot of what we need to do. And we've got to make sure that we maintain

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

these assets and keep their reliability. All of our CapEx does not necessarily go just into growth, it also has to make sure that we improve our cost position through this cycle so that the next cycle we're able to weather the next cycle as well.

Operator

And that will conclude today's question-and-answer session. At this time, I would like to turn the call back over to Mr. Neal Sheorey for any additional or closing remarks.

Neal Sheorey ***Dow Inc. - VP of IR***

Thank you, everyone, for joining our call. We appreciate your interest in Dow. For your reference, a copy of our transcript will be posted on Dow's website later today. This concludes our call. Thank you.

Operator

And that will conclude today's call. We thank you for your participation.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Briefs are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT BRIEFS REFLECTS THOMSON REUTERS'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT BRIEF. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019 Thomson Reuters. All Rights Reserved.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.