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Dow Inc.

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Jeff Zekauskas: Hi, good morning. This is Jeff Zekauskas, the chemical analyst at J.P. Morgan. This morning, it's my pleasure to welcome you to the J.P. Morgan Virtual Industrials Conference. The format of our conference is virtual in the interests of health and safety. We very much appreciate your attendance.

For today's fireside chat, you can submit questions by emailing me at jeffery.zekauskas@jpmorgan.com or by using the conference website through the Ask a Question feature.

It's my pleasure this morning to introduce Howard Ungerleider, who is the President and Chief Financial Officer of Dow Chemical. Howard has been a long time Dow veteran, both on the financial side and on the business side. Joining Howard is Colleen Kay and Pankaj Gupta in investor relations.

As a reminder, this event is open to the public. Please refer to the cautionary and forward-looking statements in the materials that Dow will pass. With that, I'll turn it over to Howard who will make some opening statements, and then we'll proceed with our fireside chat. Howard?

Howard Ungerleider: Thanks for having us, Jeff, and good morning to you and good morning to everyone. Jeff, I answer to any name and any title, so you just feel free to call me whatever you want.

I really appreciate the opportunity to provide an update on the quarter including the impact of winter storm Uri. Perhaps you want to talk a little bit about changes. We recently announced to our US pension plans and of course our continued focus on driving long-term growth in our enterprise value.

Now, as we shared on our fourth quarter earnings call, we exited 2020 with increasing

momentum. Underlying market fundamentals, frankly, have only continued to improve in the first quarter, despite the unexpected disruption from winter storm Uri in February, which was significant.

Demand for packaging applications continues to remain resilient. What we've seen is really construction, automotive, and manufacturing production really continue to trend positively. Just a little bit of a stat, new US housing stats and existing home. Sales are up double digits over last year.

Frankly, they've reached now levels that we haven't seen since the economic up cycle of 2005, just to put those statistics in perspective. The Dow team continues to proactively capture these favorable market dynamics, managing through the winter storm impact, as well as several planned turnarounds.

In polyethylene, we achieved price increases in January, and February, and March. We also have nominations in place for April as a result of the continued solid demand momentum, the disrupted supply conditions, and the very, very tight chain inventory levels that we see.

Strengthening demand and industrial and consumer durable goods end markets combined with industry tight supply and low inventory levels have also supported margin strength in MDI and polyurethane applications.

In our silicone business, it's beginning to benefit from industry demand improvements in consumer end markets, such as electronics, home care, and mobility.

What we're seeing now is particularly strong in our higher-margin offerings, which was lagging when you think about the last half of last year. Then in our coatings business at the do-it-yourself, coatings demand continues to remain high as consumer home improvement trends continue.

In addition, I would say our previous and our ongoing investments in lower risk, faster payback expansion, the bottleneck projects in silicones and industrial solutions continues to enable data capture, the strengthening demand we see in automotive, and electronics, in pharmaceutical markets as the global economy continues to recover.

In terms of winter storm Uri, first, let me just say how proud and thankful we are that Team Dow remains safe as our team took swift action to activate our preparedness plans and move rapidly to respond. Winter storm Uri had a broad impact on the US Gulf Coast, in particular across the

entire state of Texas, and resulted in widespread utility and raw material supply disruptions.

This was a very significant event for the entire industry, and I would say much more significant than a typical hurricane as it covered the entire state. It impacted almost all the gas fields plus the entire electrical grid in the state.

While Dow like many others in the industry experienced production outages predominantly across Texas, I'm proud of the fact that our team successfully began to bring our impacted assets back online as early as one to two weeks from the storm's peak.

As of today, I'm pleased to report that all of our crackers on Dow's US Gulf Coast are operational, with the one exception being Sabine River.

Sabine will restart later this month. We expect all of the assets impacted by the winter storm to continue to ramp through the end of March and into April, as we still are dealing like many others are, with a few raw material constraints and we are continuing to do some freeze damage repairs.

In general, I would say we expect our Texas assets to be at 80 percent rates by the end of the month and full rates at some point before the end of April. That'll enable us to begin to fulfill the backlog of demand which is pretty significant. Dow's ability to rapidly respond and restart is a true testament to Team Dow's dedication and our pride of ownership.

Once all the units are back at full production rates as we do with all significant operational events, we'll be taking a look at additional maintenance and improvements and incorporating all of our learnings into our future plans.

While many of our businesses declared force majeure on products in the aftermath of the storm, our teams are certainly working hard to mitigate the operational and customer impact as much as possible. We continue to stay as close to our customers as possible as these product and supply chain impacts across the industry have clearly created extremely tight supply balances.

Now, as all units come up, we'll continue to work through the backlog of orders and the pent-up demand in each of our value chains. Assessment of the financial impact due to the storm is still underway.

Despite the impact from the shutdown to repair the ramp-up costs, we actually today expect net upside for the quarter from the tight dynamics we're experiencing across both durable and

consumer end markets, resulting in first-quarter results that should be $50-$100 million higher than the current First Call EBITDA consensus estimate.

Moving forward into the second quarter, we expect these strong supply-demand fundamentals to continue in light of the order backlogs that I mentioned, the pent-up demand, and the low inventories and most of the value chains that we see. As of right now, I would call the upside of at least $300-$400 million versus the current second quarter First Call consensus EBITDA.

When combined with the continued recovery that we see from the pandemic driven by increased vaccinations, further economic stimulus out of Washington, rising demand as the service sector reopens, and frankly, an expected increase in industrial capital spending, we expect these tailwinds to continue into the second half of the year as well.

Of course, we'll share more detailed guidance, Jeff, for the second quarter during our earnings call in April. A couple of other things before we turn it to Q&A, I would say earlier this month we announced updates to our compensation and benefit programs.

We followed a comprehensive review, a benchmark relative to our peers, as well as a survey of our organization in order to better align with the market as well as the needs and preferences of Dow's globally diverse workforce, while also continuing our focus on financial flexibility and of course continuing to strengthen our balance sheet.

This included the decision to freeze our US pension plans as of December 31, 2023, which is a shift in line with the industry trends and market practice today.

We also made a one-billion-dollar voluntary plan contribution to our US-defined benefit plans this month as a result. These actions will enhance the strength of our balance sheet by reducing our pension plan obligations by approximately $350 million.

It'll decrease our pension expense related to the US plans by more than $160 million this year. It'll also improve the funded status by almost $1.4 billion, and it'll eliminate required pension contributions for the US plans until 2024.

Beginning next year, the annual benefit cost reduction will be partially offset by a higher company match of employee contributions to the US defined contribution plan. We'll have more details on this along with an updated view of our full-year model and guidance to share on our earnings call when the pension remeasurement is complete.

Finally, Jeff, what I would say is looking ahead, we continue to be very well-positioned to capture additional value-creating growth. We expect new consumer behaviors that have emerged during the pandemic to continue to benefiting our consumer led portfolio as the global economy continues to recover.

In spite of the weather related events that we talked about already, market indicators continue to show above GDP growth across many of the sectors where we compete. We see the new orders to inventory ratio from the manufacturing PMIs remaining above 50, which also reinforces continued expectations of market expansion.

Against that backdrop, we expect to see the recovery broadening across our portfolio, including our higher margin consumer solutions, our PU systems and our functional polymers business, which all serve mobility, infrastructure, and construction and markets.

Really, as an example of this momentum, this month we signed an MOU to build a specialties hub in China, to provide customers in this high growth region, local access, the Dallas portfolio of high value products and PU systems, as well as EO and PO derivatives and applications like automotive, pharmaceutical lubricants and adhesive segments to just name a few.

We also recently started up a new PEG unit on the US Gulf coast, which positions us for further growth in the pharmaceutical and consumer product applications, which as you know, grow at a rate of between two and three times GDP.

We also continue to advance our ESG focused ambition. Our proxy statement and our annual report were released earlier this month and they highlight our ESG actions across the company. This year we plan to expand our accountability for our inclusion diversity and our equity performance award targets to all of our people leaders, really increasing the shared ownership of these critical performance metrics.

As part of our board succession planning and refreshment actions, we've nominated two new directors for election at our upcoming annual meeting, which further will bolster the strength and the diversity of our board.

We also launched a new ESG resources section on our investor website, really to just continue our path of increasing our transparency and ease of access to all of our metrics, including our ESG metrics, which we encourage everyone listening to please visit the website.

Contributing to progress on our sustainability targets, our packaging business recently launched AFFINITY™ RE. It's a new sustainable hot melt adhesive polyolefin elastomer. It's made using a hundred percent bio-based feedstock.

It delivers a 45 percent lower carbon footprint, and it really capitalizes on the strong growth in consumer packaging and e-commerce without compromising on adhesion performance.

Our commitment to sustainable innovations like AFFINITY™ RE in collaboration with our customers, combined with our digital acceleration investments, our global scale, our low cost structure, our industry leading feedstock flexibility combined with our significantly improving financial flexibility, will all continue to drive long-term growth in our enterprise value.

Jeff, with that, I'll hand it back over to you to open the Q&A.

Jeff: OK. Thanks very much for the summation, Howard, and the slides. I don't have a first call monitor in front of me, but my memory is maybe this second quarter first call estimate for Dow and EBITDA terms was about $2 billion. If you add 400 to that, that's 2.4. If you annualize it, it's 9.6.

Is that order of magnitude what we're talking about, if it turns out you were able to maintain your second quarter level of profitability through the course of the next 12 months.

Howard: I mean, look Jeff, the first year you don't have a first call monitor, but you're very close. I think first call is just shy of $2 billion. You're right. If you add $400 million you're at $2.4. Your math is correct. I would say this, let's deal with it one quarter at a time.

As we see the first quarter as I mentioned in the prepared remarks, we entered the year with momentum. That momentum has continued. Despite URI, we're able to offset all the headwinds of URI based on that momentum in terms of volume and overall margin, and we've been keeping costs under control.

That's why we say, "Look, we see $50 to $100 million upside versus the consensus estimate in Q1." It's still early. We'll have more to say on the April Q1 earnings call about the second quarter.

I wanted to take this opportunity to at least share with you what our thinking is. That's $400 to $500 million of tailwinds or upside versus the current consensus for the first quarter, which is just

above $2 billion today.

Jeff: That's a pretty good quarter, Howard. The second quarter of 2021, the peak as a base case. Now I understand oil can go up, and what that can do is that can alter things. Just conceptually, as you look at the flows of commodities, and it may be that it comes off by just a little, but should the second quarter have the peak-like characteristic?

Howard: It's very dangerous for anybody to call a peak or a trough in advance. My short answer to your question, Jeff, is no. We are far from an earnings peak. If we were able to deliver a $2.4 billion second quarter, that certainly feels a lot better than the second quarter a year ago. Or even what we did in the fourth quarter. It's still far away from peak kind of numbers.

If you go back to when we spun out the new dial and we looked at the portfolio, at that point in time we were looking at an earnings peak of $12 to $13 billion of EBITDA. I would say since then we've continued to invest in additional growth capacity and we've continued to take costs out. Essentially we've lowered the breakeven point of the company.

You're looking at, I would say today, peak numbers are $13 billion plus from an EBITDAR perspective. Even if you take your 2.4 and annualize it, you're still far away. Then you look at the economy. Certainly packaging has continued to be resilient.

It surprised most players that through the economic depths of the pandemic polyethylene demand actually rose two percent last year. A big part of that is everybody was consuming, but consuming more in their homes and less in restaurants, hotels, travel, and stadiums, and theaters, etc.

Your amount of packaging per square inch of food consumed as an example went up. That's what allowed the market to continue to grow even though overall GDP reduced. There are many value chains that even sitting here today in March of 2021 are well below normalized.

If you think about travel, you think about commercial construction, you think about industrial CapEx. You think about the entire service sector, which does drive demand for a lot of the products that we serve as well, all of that is in very early innings of return. There's a lot of potential upside in front of us over the next several years.

Jeff: What we had was a freeze in Texas. Maybe we lost, I don't know, three weeks of polyethylene production, so maybe that's six percent of an annual amount. Braskem Idesa has been off and on because of their negotiations and trying to get feed stock.

Maybe the market is, I don't know, 10 percent short in polyethylene. Then the challenge for the industry is going to be to boost production, to try to balance markets more. Do you think that that's a reasonable assessment, and how long do you think it might take before the market can be more imbalanced in the United States in polyethylene?

Howard: I would say a couple of things. When you look over the last 10 years, I would say that certainly our P&SP business has been a very good earnings contributor, a very good return on capital and cash flow generator.

While it certainly has been up and down, I would say it's been an earnings ridge really since probably 2013 timeframe, maybe with the exception of a little bit of the margin destruction that we saw as a result of the pandemic and hydrocarbons prices, because of oil dropping this time last year.

You look on a go-forward basis, there is good demand growth. Yes, there is supply growth, but I would say it's in the margin of what the expected demand growth is. Certainly there are bulls out there and there are bears out there.

Personally, my view is we've been in an earnings ridge for the last seven years plus or minus, and it's likely the next three to five years is also to see a similar activity. What we saw with the freeze is we're one issue, one weather event away from supply-demand tightening operating rates. It doesn't take much to tilt the market.

The reality is every year, the grid, even with the new capacity that's been coming on, since 2015, and is forecasted to come out in the next three years, every year, the grid on average does get a year older.

Whether it's unplanned events because of mechanic asset, mechanical reliability, whether it's a weather event, or whether it's just aging assets that get taken out, or unplanned events, this year, the other thing that was certainly going to be true even before the winter storm Uri, is there was a significantly higher percentage of planned maintenance turnarounds in 2021 than in 2020.

Dow, just as an example, last year, we had one cracker for planned maintenance. This year, we've got, depending on how you do your math, three or maybe three-and-a-half because we have to take a pit stop for our assets down in Argentina, so we got three-and-a-half.

I don't think were an anomaly. We're representative of the trend. So there's going to be significant planned maintenance that needs to happen to these assets in the grid as well. We'll see what the next several years are, and obviously, it'll depend on your point of view on the reopening of the economy and how much demand growth we get.

Depending on your point of view, GDP globally this year between five to six percent is in line with most of the economists, if you look on the Bloomberg terminal. If you think about ethylene derivative demand growing it, conservatively one times, and optimistically one-and-a-half times. You're talking about significant demand growth this year and into next year as well.

Jeff: I do notice that polyethylene prices in the United States are maybe a few hundred dollars a ton higher than where they are in China. Normally, from my point of view, the US price is that a little bit of a discount to the Asian price.

What I had thought was that our prices were more elevated and we were such an expensive market that we weren't exporting it anything like these kinds of prices. That's why I thought that there might be some moderation in the short term. Do you think that's reasonable or it's too hard to predict?

Howard: I would say it this way, Jeff. In many ways, it's not really a global market. It's pretty much, depending on how you do your math, four to five regional markets that are all connected with physical arbitrage. It is not surprising, given the winter storm, that the US prices moved up faster than some of the rest of the world, but the reality is the markets are interconnected.

What you will see, and you're already starting to see, prices in Asia, prices in Europe moving up because of that interconnectedness. There are traders out there that will try to bridge that arbitrage and close those arbitrage gaps. It typically takes, I would say, three months, plus or minus, for the global market prices to calibrate.

A bear might say the US price will come down. I would say my view is actually Asia prices, and European prices, and Latin American prices are moving up. That's a lot more likely to happen based on where I see the demand picture and the supply.

When you look at the European market right now, you've got at least a couple of players in Europe on force majeure having nothing to do with winter storm Uri, but because of some mechanical issues that they're experiencing in Europe.

Obviously, Asia is still a net importer of polyolefins, and so they are going to have to deal with lower imports which is certainly going to drive pricing up in Asia. My best guest today, Jeff, is that's how things calibrate. But it's going to take some time.

When you think about a typical hurricane or a typical typhoon in Asia, it's typically three months before you see things calibrate. Given the extent of the damage and the capacity that was taken offline with Uri, it's a six-plus month event before we start to see things calibrate back to just fundamental underlying demand.

Jeff: The Sadara had all of these struggles over the past several years, but wasn't that built for sort of a higher oil price environment? Shouldn't that have a better contribution in 2021?

Howard: It should. I probably would reject the "struggles" comment. I would say that we're very proud of the Sadara team. The assets have been running extremely well since day one.

The assets were sold out very quickly. Remember, it passed a lender reliability test on the first go when it had three years to pass it but it passed on the first try even surprising ourselves because we figured we'd have to do it twice to solve some of the punch list items.

You're right. Look, it has been improving. It's been improving because of lower cost. We've taken cost out, Sadara team has taken cost out, they've continued to creep the assets, and they've continued to sell up the value of those assets.

In the fourth quarter, Sadara improved their results by over $130 million versus Q4 a year ago. Was the first quarter where it actually had a profit, was a positive contributor to Dow's equity earnings on an EBITDA basis.

I would say their portfolio definitely mirrors our portfolio. As our earnings have improved, I would expect Sadara to be a much bigger positive contributor to both Saudi Aramco and Dow in 2021 relative to 2020.

Jeff: What about the MDI markets, Howard? Those have been pretty tight. How is your production? Are your prices moving up? How's profitability in MDI?

Howard: If you think about the pandemic and you think about isocyanates, a large portion of isocyanates go into durable goods. If you think about the pandemic and what that did to automotive and construction in the second quarter of a year ago, that was the value chain in Dow

that was the hardest hit.

We match production to demand, you're talking about operating rates that went down in the mid-50s in order to keep pace with the demand. I would say, since the third quarter of last year, the durable demand has continued to increase, frankly, at a pace faster than we had originally expected.

We went from polyurethanes essentially being breakeven cash margin to having some reasonable profitability in the fourth quarter, but still way below normalized. Maybe slightly above trough type economics. I do expect in the first quarter and again in the second quarter for that to continue to improve.

When you think about isocyanates, there's not a lot of new capacity slated to come on until at least mid-2023. If you believe in continued economic expansion, which we do, it should be a good few years for the polyurethane franchise in Dow to continue to drive higher earnings.

Jeff: In your opening comments, you mentioned some recovery in your silicones and siloxane business kick. Can you expand on that a little bit?

Howard: Certainly, and I would say that there was, certainly last year and the year before, some additional siloxane capacity that came into the marketplace. That drove siloxane pricing down. Then when you think about the downstream markets, a reasonable chunk of our performance silicones goes into personal care applications.

When people were in quarantine, or locked down, or weren't going out, and wearing face coverings, they just weren't buying the higher-end cosmetics, the higher-end lotions and potions that drive a lot of our margin growth.

Plus, commercial buildings, high-rise buildings, that's another big area where we participate. What we started to see, it lagged. When you think about our P&SP business, really led out of the pandemic. Polyurethanes and acrylics were next, and silicones lagged because of the combination of too much supply of siloxane and then not enough demand because of the pandemic.

We started to see that improve in the fourth quarter and as this year progresses, we'll see continued demand growth with the reopening on some of the higher-margin applications, like personal care, commercial buildings, industrial CAPEX, plus automotive.

When you think about the expanded mobility, whether it's EV, we sell a lot more pounds of silicone in an EV car than in a traditional industrial combustion car. As the market continues to go EV, as the world continues to implement 5G technology from a telecommunications standpoint, those are all going to be key drivers of earnings growth for our silicones franchise over time.

We'll continue to drive higher earnings from siloxanes upstream as both the supply-demand balance improves and as we continue to take more siloxanes out of the merchant market and grow our downstream formulated silicones business faster, which has certainly been the strategy and will continue to be the strategy.

Jeff: Thank you for that. Howard, in your coatings and intermediates business, you use a lot of propylene. Propylene prices have tremendously escalated over the past three months.

When you think about coatings and intermediates, but just Dow's position in propylene generally, is the elevation in propylene good for Dow, or is it something that holds it back over a shorter period of time? How do you analyze the puts and takes?

Howard: From a Dow coating material standpoint, you're right. I would say in our emulsions business, we do sell merchant monomers, and so you tend to get price on the merchant monomers much faster than you get it in the downstream emulsions.

I would say there's typically a, call it, two to three-month lag on the downstream emulsions because you just can't move price as fast on the emulsion side.

In the near term, in the coatings and monomers business, more the coatings and the monomers, that rise in propylene cost will be a headwind for the business but over time will recoup that. It's just going to take a few extra months.

Jeff: On balance, is the rise in propylene a positive for Dow or negative?

Howard: If it's sustained, it's a positive. If it's whipsaw volatility, then it's probably a negative, Jeff. At this point, I would call it a net positive over the course of 2021. If you think about it from a full-year standpoint versus where we were before, it's a net positive.

Jeff: If we can just turn to some general issues with Dow, I was always struck by the last days of DowDuPont, when different parts that were more specialty inside of Dow were moved into the

DuPont portfolio. I think that that came about because some people thought that maybe they would be valued more appropriately close to the market value.

When Dow now formulates its strategy going forward, are you in any way affected by that experience? That is, are you more reluctant to build specialty parts of your portfolio or do you want to build tech specialty parts of your portfolio and separate them out? How do you come to terms with that experience that the company had?

Howard: When you think about the new Dow, we take about five or six different molecules. You think about olefins, you think about acrylics, urethanes, silicones, alkoxylation capability, and we add value.

Three large market verticals and several others which we can talk about. The three big ones are packaging materials, infrastructure materials, home and personal care materials. We also have an emerging mobility franchise, so we sell about two billion dollars' worth of revenue a year into the mobility segment. That's why we launched our mobility sciences last year.

I would say, Jeff, people talk about specialty and commodity and I think it's a little bit of the old saying of tomayto, tomahto. My view is today's specialty is tomorrow's commodity.

I am a big believer in capitalism. Ultimately drives everything to NPV or economic profit breakeven without intervention. That's why you have to intervene. You intervene on your cost structure. You intervene with customers by innovating and figuring out what they need and what they want and delivering solutions to solve the problems that they tell you they have.

If you're really good, you help them solve problems that they didn't even realize that they had. That's how I think about who we are. You think about the ambition that we've laid out, our goal is to be the most innovative, most customer-centric, most inclusive, and most sustainable material science company in the world. That's what we're marching toward.

You think about our capital allocation priorities, fundamentally, to safely and reliably operate our assets, to continue to pay an industry-leading dividend, to continue to grow our positions, whether that's upstream and making sure we maintain our low cost to serve, or continue to preferentially invest in our downstream products, because that's typically where the higher margins are that are more stable over time.

That's who we are and that's what we're about. I'm very proud of team Dow for doing all the hard

work for the last several years. What you're seeing now is a continuation of that earnings growth, the cash flow growth, and the return on capital growth.

That's our focus over the economic cycle. Grow earnings, grow cash flow, and grow our return on capital.

Jeff: Dow has been a company that's had a relatively low level of capital expenditures. Maybe since you built Texas nine, going back to 2017, 2018. Now you're a much more profitable company, but at the same time, your overall capacities really haven't altered so much.

In terms of creating value for the Dow shareholder over a longer period of time, how do you balance the claims of the benefits of additional capacity growth, and providing more cash to your shareholders relative to your recent history?

Howard: Our focus is on long-term growing our enterprise value. We were very early. We were first or second, depending on how you do the math on investing in the US Gulf coast. We spent $7.5 to $8.5 billion.

We added three billion pounds of polyethylene capacity and more than four billion pounds of ethylene capacity to go into polyolefins, elastomers, our functional materials, as well as our EO derivatives as well.

We continue to have growth investments. It's not really necessarily about volume. It's really about value today, continuing to go downstream whether it's the new PEG facility that I talked about, that we just started up, or the specialties hub in China that I talked about in the prepared remarks.

We're also investing upstream. We are going to get a full year now out of Texas nine, the additional two furnaces. We're investing in the new furnace in the Fort, in Canada, together with one of our joint venture partners.

Then from a silicones perspective. You think about all the downstream, the bottleneck. We did 10 of them last year. We've got another probably 10 to 12 that we'll do this year and next year to continue to grow our formulated silicones, our downstream performance silicones business. That continues to be the focus, Jeff.

Jeff: Howard, I remember when we had this conversation a year ago it was a darker...

[crosstalk]

Howard: It was.

[laughter]

Jeff: Oil prices were falling I suppose to none. I'm very glad your businesses have recovered. We wish to have a very good fortune in the coming year. We hope you'll return to chat with us next year.

Howard: Thanks, Jeff. I look forward to next year in New York together. Maybe even a hug, depending. We'll see.

Jeff: I don't know about that. [laughs] Take good care, Howard.

Howard: Take care, Jeff.

Jeff: Thank you.

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