

Dow Inc.

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Jeff Zekauskas: Hi, good morning. I'm Jeff Zekauskas. I cover chemicals for J.P. Morgan in North America. This morning it's my pleasure to welcome the management of Dow. Representing Dow is Jim Fitterling, who's been CEO of Dow since 2018 and previous to that, he managed the Dow entity under the Dow DuPont structure. Jim is a tremendously experienced executive who's managed...Maybe Jim, you've been at Dow for 40 years?

Jim Fitterling: 40 years.

Jeff: 40 years, and has managed Dow's most complex businesses ably. In the front row is Pankaj Gupta who is the head of investor relations at Dow and has an encyclopedic knowledge of what Dow does.

The format today is a fireside chat. I think Jim has some introductory remarks to make. We welcome you to our conference.

Jim: Thank you Jeff. It's great to be here and nice to see all of you.

Dow continues to work to demonstrate our commitment to financial and operational discipline as we navigate a pretty dynamic macroeconomic environment out there and also continue to invest for long-term profitable growth.

We're making good progress on our Decarbonize & Grow strategy, including our Path to Zero project in Fort Saskatchewan, Alberta, where we announced the final investment decision at the end of last year.

In the Path to Zero project, since the end of last year, all of our long lead-time equipment items have been locked in which further demonstrates our focus on making sure that we're cost effective and managing risks of the project.

This quarter we also entered into a long-term agreement with Pembina to supply and transport up

to 50,000 barrels per day of ethane.

Pembina brings leading ethane supply and transportation expertise as well as extensive integrated value chain. With this latest agreement, we've locked in the majority, I'd say close to 80 percent, of our cost advantaged ethane supply with multiple suppliers in the region.

Construction on Path to Zero is on track to begin in the second quarter of this year, which will be another important milestone. The project itself will create the world's first net-zero Scope 1 and 2 emissions ethylene and derivatives complex. Overall, this single project is expected to deliver one billion dollars of EBITDA growth at full run rates over the economic cycle.

Our Fort Saskatchewan project will have a lower capital intensity than our Texas-9 cracker which since it started up in 2017 has delivered more than 15 percent return on invested capital. That project in Saskatchewan builds upon the foundation of Texas-9 where we proved our best-in-class execution, capital efficiency, reliability, and emissions reduction.

In addition to our Decarbonize & Grow strategy, we continue to advance our Transform the Waste strategy via intentional actions strategic partnerships and offtake agreements.

In the fourth quarter, Valoregen in France achieved mechanical completion of a 15,000-ton-per-year mechanical recycling line. Mura Technology in the UK commenced commissioning, which is expected to contribute 20,000 tons per year of advanced recycling capacity. Both Valoregen and Mura expect to reach full commercialization in the second half of this year.

All in, we expect our initiatives to develop a circular ecosystem to generate more than 500 million of incremental run-rate EBITDA by 2030.

As we execute on the long-term strategy of Decarbonize & Grow and Transform the Waste, we also are leveraging our competitive advantages, our recycle growth investments, and our operational discipline to make us well-positioned to create shareholder value.

When you look at our portfolio, the differentiation in our portfolio with structurally advantaged assets from a cost position, global scale and strong cost positions enabled us to competitively support global demand growth over the cycle.

Healthy oil-to-gas spreads which are supported by growing natural gas and natural gas liquids production in the US favor our cost advantage and our ability to capture margin momentum.

We've also taken actions to position Dow for profitable growth, including ongoing execution of our near-term investments that are expected to deliver approximately two billion dollars in incremental underlying EBITDA by mid-decade.

Since 2021, we've added investments and capacity to unlock approximately $800 million of incremental mid-cycle EBITDA through our near-term organic growth investments, which include our FCDh unit in Louisiana which makes propylene from propane, our alkoxylation capacity investments in the United States and in Europe, which go to attractive segments in our Dow Industrial Solutions and Consumer Solutions businesses such as consumer and pharmaceutical applications.

In addition, we've invested in multiple downstream silicone debottlenecks globally to address fast-growing applications in mobility and electronics. We're on track to achieve the remaining $1.2 billion of our near-term EBITDA target by mid-decade, enabled by lower risk and higher return growth projects.

These investments support faster payback, higher return on invested capital, and lower risk projects and are focused on opportunities with greater demand resiliency throughout the cycle.

In addition, we've improved our cost profile, delivering more than $1 billion in targeted savings in 2023. Our disciplined and balanced approach to capital since Spin has given us the financial flexibility to continue covering all of our capital allocation priorities as we navigate the bottom of the cycle while investing countercyclically in higher return organic growth projects to capitalize on the next upside in the global economy.

Looking back over four decades, Dow's balance sheet is in the best position it's been at this time in the cycle. We have a strong investment grade credit rating and we're executing high return organic growth projects, and we're executing them on time and on budget.

All of our debt is at fixed rates with no substantive debt maturities due until 2027. We have approximately $13 billion of available liquidity. We delivered approximately 96 percent cash flow conversion in 2023.

Our continued focus on tightly managing costs and maximizing cash flow led to that 96 percent cash flow conversion. This year we have more than $1.5 billion in unique to Dow cash levers that we expect to deliver on.

In total, we've returned approximately 90 percent of our operating net income to shareholders since Spin, which is well above our 65 percent target over the economic cycle. We continue to navigate near-term macroeconomic dynamics with mixed indicators across the markets we serve.

We saw some positive indicators, including an 18-month high in global manufacturing PMI, moderating inflation levels in the US and in Europe, and a normal seasonal uptick in new and existing US home sales in January.

High interest rates still continue to limit overall consumer demand, primarily in consumer durables and in building and construction markets. In the United States, polyethylene contract prices settled up five cents per pound in January and remained flat in February.

The price increase early in the quarter was primarily driven by continued strength in both domestic and export demand, as well as tight supply in the early part of the year due to some impacts of Winter Storm Heather in the US Gulf Coast.

In Europe, despite lower sequential energy prices due to the mild winter, near-term consumer and industrial demand remains weak. In addition, geopolitical tensions in the Red Sea have led to higher freight costs globally.

In China, we expect to see demand recovery in the second quarter after a slower February due to the Lunar New Year with overall 1H24 economic growth at a similar level as 2023.

We'll continue to leverage our competitive advantages and diverse portfolio to capture demand and deliver volume growth in most of our value chains as the markets recover. With all the puts and takes, we expect first quarter revenue to be flat sequentially and EBITDA to be up sequentially.

This is in line with the previously provided guidance at our fourth quarter earnings call and the current consensus.

In February, we issued $1.25 billion of green bonds to support eligible green projects, including our Fort Saskatchewan project, further demonstrating our financial commitment to higher value sustainability investments. The issuance received significant market interest, was well oversubscribed, and allowed us to get highly competitive rates and our lowest spreads in 25 years.

The 10-year bond was priced at Treasury plus 105 basis points, and the 30-year bond was priced at Treasury plus 130 basis points of spread.

Throughout the cycle, our strong financial position has enabled us to continue investing in both Decarbonize & Grow, and Transform the Waste strategies, each of which will support profitable growth into the next decade.

We expect to increase underlying earnings by more than three billion dollars, and reduce scope 1 and 2 emissions by an additional five million metric tons versus 2020, while also commercializing three million metric tons per year of circular and renewable solutions by 2030.

Altogether, we remain confident in the long-term earnings growth trajectory, and we will continue to lead the industry to a more sustainable future while maintaining a disciplined and balanced approach to capital allocation.

With that, Jeff, I'll turn it back to you.

Jeff: Thank you for that summary.

I was looking at the three slides you've brought.

Jim: Sure.

Jeff: It looks like there's about 50 items on the three slides.

Jim: [laughs]

Jim: You're right.

Jeff: I was wondering that, as the CEO of Dow Chemical, what do you focus on? When you think of your own principal priorities in 2024, where do you devote your energies, and what are the analytical puzzles that you try to crack?

Jim: I would say people, obviously, number one. You can't do all this without a great team. We work hard on culture to try to attract and retain the best people that we can get.

I spend a lot of time on policy, because I think in order to deliver on these strategies -- whether it's Dow's strategy or the energy transition in general -- you need good policies to support that.

More and more, the politicians need industry at the table to really have a good understanding of the supply chains. Politics have changed a lot. We don't have the institutional knowledge of how things are made or where they're made, and so spending a lot of time to do that. I would say it's more than education, but it's just a deeper understanding of that takes time.

Then, an awful lot of time with the team and the business units, going through their priorities and challenging that and stress testing that, making sure that what we're delivering matches up with what we're seeing in the external marketplace so we get a gauge of are we winning or losing, gaining ground or falling further behind?

And then portfolio. We invest in the dollars in the right place in the portfolio. Are there parts of the portfolio that we can liberate some cash like we're doing with infrastructure today? How can we redeploy that cash so that the next trough is higher than the last and the next peak is higher than the last. That's what we're trying to do with the organic investments right now.

Jeff: One of the things that I see on your slide is it says you've locked in a majority of long-term cost advantage ethane supply in Canada. What does that mean? In the United States, I think people mostly buy ethane under shorter-term contractual arrangements. What does it mean to lock it in for 2027 to 2029?

Jim: The Canadian market's very different from the US market. You don't have as much downstream infrastructure in the Canadian market as you do in the US, and there's fewer players. Typically, to develop a project like our project in Canada, you work with the large players to develop the fields that will supply your project.

There is a gas gathering system like we have at Henry Hub. There is the AECO system in Canada. For more than a decade, for more than 20 years, that has always been a lower-priced source of ethane than the US Gulf Coast. It's ranged as high as 90 cents a million BTU, if you think about it in gas terms, . cheaper than the US Gulf Coast, and so we call that the Alberta advantage.

What it requires you to do is you have to have a long-term view to the project, you've got to make a long-term commitment to be able to get those projects to be bankable for the downstream or the upstream suppliers, and then you have a really strong long-term partnership with them.

So Pembina and Wolf are two of the primary suppliers for this. They'll supply the vast majority of what we get. Wolf is also the company that has the carbon capture trunk line, called the Alberta Trunk Line, that will take the CO2 from the Path2Zero project to sequestration.

Jeff: Does that mean that you know your ethane price in 2027, or does it just mean that you know your ethane volumes from particular suppliers?

Jim: We have good line of sight to what the price will be now through then, yeah. Obviously, you look relative to market, right? You know that the market will move during that time period.

Jeff: Sure.

Jim: You know relative to market where you're going to be.

Jeff: Does that mean that the ethane would be priced relative to whatever Canadian gas is in 2027?

Jim: That's a good way to think about it, because in Canada, the way the policies are set up, they want to keep the ethane and the propane in province if they can, to create higher value out of it. They might move the natural gas into the North American market, into the US, to be able to access a bigger footprint.

Jeff: What you've done is you've assured your supply, and then you've also assured that you're not faced with some volatile eccentricity of ethane price relative to natural gas.

Jim: Right. That's why I mentioned policy earlier. You need to make sure that the Alberta government, the federal government, are going to support long-term growth of natural gas. It's obvious that Canada will. They're going to need it for a reliable power supply. They're facing some of the similar challenges that we face in the US.

Electricity demand is going up for the first time in more than a decade, and it's going up pretty substantially. We're going to have a hard time. We won't have enough baseload power to provide all that electricity.

The only thing that you can do in the near term would be a gas-fired power plant with some kind of a scrubbing system to get the CO2 out, or maybe hydrogen and carbon capture if you want

reliable baseload power.

Otherwise you're talking about gas without scrubbing, or coal, to be able to deliver it, because you'll not get a nuclear plant up in that time period, and the wind and solar and batteries won't provide it.

Like in the US that we're experiencing it right now, they've experienced it this winter, had to import power from Saskatchewan to Alberta in the really peak cold months to beef things up.

Jeff: Today, the price of natural gas in the United States is, I don't know, $1.50 per...

Jim: Buck 60, probably.

Jeff: Yeah buck 50, buck 60. When you have your base case for what your gas costs will be in 2027, is it three or five or four or some other number?

Jim: When we look at long term, there's a lot of logic that says in that 2.50 to 3,50 [$/MM BTU] range, as you look out say five years. For the gas market, beyond five years, there's no physical market even a year out. It's a month-to-month thing. We don't tend to financially hedge natural gas. We physically hedge it.

We use so much natural gas, that we look at physical hedges to manage it. Just based on supply-demand balances, and the low cost, and the speed at which we can get capacity online because of the shale gas, it looks to us like 2.50 to 3.50 [$/MM BTU]. What we saw during really peak times, during COVID, was it bumped up above five dollars [per MM BTU].

You could have excursions like that if things got extremely tight in the wintertime. You can see that happen. That happened to be when Ukraine and Russia conflicts started. Europe natural gas prices were $30, a million BTU, maybe as high as $60 [per MM BTU] on the spot market at times.

US has got a great long-term low-cost position, Canada's got a great long-term low-cost position, and that's what underpins everything we decide to do downstream. That's the structural cost advantage that we can build the rest of the business on.

Jeff: You don't have a view that so much LNG will be exported out of the United States that it will lift the gas price or make the gas price more global, your base case is that the United States will remain at a discount to the world. Is that fair, and why do you think that?

Jim: There is a global competitive LNG market, but there are very few suppliers to it. Australia, Qatar, United States a handful of others, but maybe six make up the global supply.

The United States is so prolific and low cost that even if we export as much as is on the books, the net back cost here is still the lowest. We have so much industry here, we have so much competitive advantage for export business that it always will work itself out that we get the lowest net back here.

From a market standpoint, it's been proven time and time again that more supply and more exports actually favor lower US energy costs and are a key part of America's competitive advantage. I think that's why you see the pushback right now on things like the pause on LNG permits. I don't think it'll be a long pause. I take the Secretary of Energy at her word, she said that.

The reality is somebody's going to supply that natural gas. We don't, the Qataris will. If we don't, then we run the risk that we start to see our gas price move up.

People won't produce because they won't see the demand, and so when they don't produce, the machine slows down like we've seen in the oil sector. When that slows down, it takes two to three years to get it back up, and those prices start to rise.

Jeff: Can you describe, Jim, why it's important to make net zero polyethylene in 2027? What is it about the world that makes that product attractive, or why Dow wants to make that kind of polyethylene?

Jim: Sure. I'll just talk about net zero anything, for that for that matter. I think the public and the trend on the need to address carbon emissions, to have a chance to have a fight against climate change, the general public has already voted. There's a problem and they want to see it addressed. We see it come through our value chain at the consumers, the retailers, the brand owners in the demands that are being made for product.

We see it when they launch new products. When they launch a new product that has recycled packaging, or has a net-zero aspect to it, or any kind of sustainability aspect to it, we see the sales pop up. Nobody's willing to pay at any price for anything.

You've got to be low-cost to be able to do it. One of the things, from a policy standpoint, that

enables us to do it is a price on carbon. Canada has a price on carbon. They have a carbon emissions trading system. They also have support like we do in the US with the IRA for investment tax credits for these type of investments for new technology.

That's important because, with most energy assets, you have a useful life of 30, 40 years. You always run into energy assets being end of useful life. What do you decide to replace them with? If you don't have a policy to drive a net-zero transition, then the easiest thing for somebody to do is replace it with the same technology that they've got today and they understand.

If you've given them some incentive to move, they'll move to the next technology. Then you've lifted the whole thing. That's why we pursued it, one. Policies are in a great place in Canada. We have an elegant design. Maybe it's unique to the ethylene chain. You take ethane to crack it to make ethylene. You make two byproducts, methane and hydrogen.

You take those byproducts and instead of burning them directly in the furnaces, you go through an autothermal reformer where you can make pure hydrogen. You can more easily scrub the CO2 out of it because it's more concentrated. You sequester the CO2. That's where the price for carbon comes in. You recover some of that.

Then you take that pure hydrogen back to the furnaces. It's a circular loop. That's what fires the furnaces. You've got ethylene, essentially, with zero scope 1 and 2 emissions. As we look longer term at how we get the value out of that ethylene, it could come through polyethylene.

It could come through other ethylene derivatives if the market develops, and the policy develops to support allocating that zero-carbon ethylene across businesses to other uses. You're starting to see that people that have made commitments to reduce their scope 1 and 2 and maybe, in some cases, scope 3 emissions where they might look to us as a feedstock supplier will want that.

They may want to make claims on that with their product. They want to make sure that it's backed up by data and by good science. When we go to make a net-zero ethylene, we know for sure that we've got zero CO2 emissions. We can monitor and measure that. We can mass balance it. We can get an accounting firm to sign off against it.

We can provide that certification that they need as opposed to having offsets where somebody might say, "I'm going to go plant a trillion trees and do this." Over time, that doesn't deliver the same amount of CO2 reduction.

It favors technology investments that can be low-cost. It helps the brand owners to be able to meet the customers' needs and make claims that are valid claims, so they're not accused of greenwashing.

Jeff: Just a last question on this. Using Canadian ethane is, historically, very inexpensive. You're building at scale. You've got infrastructure that's already in place. Are these assets as low-cost as what you have in Texas in theory?

Jim: Yes. You'll have a little bit higher operating expense for scrubbing the CO2 out. You've added a unit operation for the autothermal reformer. You've got a higher operating expense to scrub it out, a little bit higher capital cost. They'll be very competitive with US Gulf Coast. It'll be a first quartile cracker even with hydrogen firing.

That's possible because you've got a policy on a price on carbon to be able to recover it, and because you have investment tax credit support from the Canadian government to help supplement that. Even on its own, even if you didn't do it with the cost base we've got on the ethane, it's a very competitive project.

Jeff: In terms of Dow in 2024 and 2025, I see Dow is in an unusual position. What I mean by that is historically, a fair amount of EBITDA volatility comes from the specialty plastics or polyethylene operation, but in the cycle that we have now, the volatility is coming from silicones, or the performance materials business, and from the MDI business inside of II&I.

Part of the issues that those businesses have is that it's not only that demand is weak, but that supply has been added by mostly in China in both businesses. When you look at those businesses, do you see them as recovering in a hockey stick fashion or more in a glide pattern because of the capacity that's been added?

Jim: Yeah, a lot in polyurethanes, for example, I would say … in performance materials and in II&I, within those, I mentioned industrial solutions and silicones, which are continuing to grow. The siloxanes capacity in China has been a drag on silicones.

The propylene oxide capacity has been a drag on polyurethanes. Polyurethanes tend to move up with the housing and construction and durable goods markets, and you see it move up. It can move up in a stair-step fashion as you start to get projects through.

It only tends to spike when you see outages or unplanned events that would cause an outage in the industry. These are big-scale applications, so if you lose one somewhere, it makes a big impact. I would say isocyanates tend to hold up better than propylene oxide, because propylene oxide goes into a lot of lower-value foams and things that are not high-quality.

Isocyanates go into rigids, into automotive & mobility, whether it's internal combustion engine or EVs. They are the highest-efficiency insulation that's out there - polyurethane insulation. The construction side tends to drive it on many fronts.

We see it in cold storage, you see it in commercial construction, you see it in residential, you see it across the board. I think that'll pick up. China has the same exact situation that we do, which is low housing and low construction right now. When that picks up, you'll see that movement as well.

I would say PO, I would expect more of a glide path. Isocyanates is running 70, 75 percent operating rates, so it may have some areas where it takes off a little bit as demand takes off. Siloxanes, most of the new capacity is in. The downstream demand continues to grow for siloxanes. Electronics drives a lot.

Last year was not a strong year for electronics. This year, I expect to be up more than 10 percent in the electronics sector. That'll be a good driver. EVs and batteries have been a big consumer. Consumer, personal care, high-rise construction or any big commercial construction that uses a lot of glass will use a lot of silicones to glaze that glass in place.

The outlook for those is going to continue to be good. I would say on coatings, architectural coatings is driven more by residential construction and a little bit commercial construction. That one is starting to pick up a little bit.

We're expecting about three percent this year volume on architectural coatings. I think it'll start to ramp up. As interest rates come down, you'll start to see the number of permits applied for pickup. There is some pent-up demand out there in the US right now in the housing market.

There's a shortage of available units for people that want to buy homes. It's the mortgage rates right now that are causing people to pause before they move in. If you think that you're on the cusp of maybe the Fed lowering rates, you might want to delay your decision a bit to see if you could get a lower rate. That feels like where we are.

Jeff: When you think about Dow and its investments outside of North America, whether it be in China, or Europe, or other regions, are those areas less attractive over time relative to North America? Is it the case that over time, Dow would like to maybe have a smaller presence in some of those offshore regions because of their cost structures?

Jim: If you look in China today, we're in the market more with downstream investments to support local Chinese supply. We don't have a big cracker or integrated footprint there. Our view is you've got to import oil, as you don't have natural gas liquids.

Even though Asia has become a little bit better on the cost curve because Europe has moved to the high [cost] position, the reality is they're both high-cost. Our view is the advantage of being in the US, or Canada, or the Middle East is going to be stronger longer-term.

The thing we have to watch out for in any of the geopolitical tensions is the unintended consequences. Both parties here seem to be looking at tariff as a way to manage this, which can be a very blunt instrument.

We have to make sure that we're in a good position to be able to protect our market and our franchise, but it doesn't necessarily mean we have to invest big capital in there.

Jeff: [inaudible] .

Jim: We've seen a big move already. If you look at how hot Mexico has become, an awful lot of the friend shoring or nearshoring that's happened has been Chinese investment in Mexico to bring the supply chains closer to home. We have to watch those trends, too.

You have to have low energy costs. Energy hits us two ways. It's our feedstock and so it drives the feedstock cost, but it's also our highest cost of converting all of those raw materials into materials.

We're not unlike steel, it doesn't take as much energy to make plastic as it does steel, but steel aluminum glass, other material transformations, they take a lot of heat and a lot of steam, and so you've got to have low energy costs. You've got to have low feedstock cost.

You've got to be able to execute with capital discipline, which we can do here in Canada, China can do as well, and then you have to have access to market, and that requires a lot of research and development. What you can make today and what's competitive today may change two or

three years from now. So you need to make higher quality materials. You've got to meet demands from the brand owners.

I think that's kind of an advantage that we have that may not be easy for the investor to see. But when we get into things like recycling, it's not just as easy as saying, "I'm going to buy waste plastic and recycle it mechanically, or by advance recycling."

You've got to make a product out of that material that meets, in some cases, food quality specs, that meets the aesthetics that a brand owner wants in their product package, something that you would buy off-the-shelf if you went into a store and you saw it and it said it was recycled. You would have confidence in it and you would buy it.

That requires a lot of innovation capability, and we are uniquely positioned to help those companies as they scale up, to be able to make high-quality products out of the recycled content.

Jeff: What I take away from that is that it's good to have a large footprint in North America. Thanks very much, Jim, for your presentation and we hope to see you again next year.

Jim: Great to see you. Thanks, Jeff.

Jeff: Thank you.

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