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Dow Inc

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Jeff Zekauskas: Hi. Good morning. I'm Jeff Zekauskas. I analyze chemicals for JPMorgan. It's my pleasure this morning to introduce the management of Dow Chemical. Representing Dow is Jeff Tate, who is the chief financial officer. Jeff is a long-standing Dow executive, though he took a break for a few years and went to Leggett and Platt to be CFO.

He's back, and he's been back since late 2023. We're very pleased to have him. The format we'll have is roughly a fireside chat, but I think Dow may have a few slides to go through first. Jeff, welcome.

Jeff Tate: Great. Thank you, Jeff. It's really nice to be here. I'll just go through a few comments...

Jeff Zekauskas: Sure. Please, take your time.

Jeff Tate: before we jump into the Q&A. The first thing I really want to start with, is the fact that Dow continues to emphasize our commitment to financial discipline. If we go to the first slide here, the thing that we really want to focus on is we have a strong financial foundation.

Our capital allocation priorities remain consistent with safety and reliability, and Dow's industry-leading dividend being at the top of the list. Now, if we continue to operate through this prolonged downcycle, our teams are taking strategic, proactive, as well as intentional actions, to support our cash flow and align our businesses to the current market realities.

For example, last month, we issued $1 billion dollars in debt-neutral senior unsecured notes at very attractive spreads, further extending our debt maturity profile. We also signed a definitive agreement with the fund managed by Macquarie Asset Management for the sale of a minority stake and select U.S. Gulf Coast infrastructure assets. I'll unpack that a little bit more as we get into the conversation.

Today, I'm also really pleased to share that we have recently received confidential draft decisions around our NOVA judgment. That's something that's really important to us. There will have to be some more calculations made to determine the final damages awarded to Dow.

We're extremely confident that the total amount significantly surpasses our prior expectations of approximately $500 million, and it will be a 2025 cash flow item for the company. Now, we expect that a public decision will be released in the coming weeks, and we'll share more related to this at this time.

Now, the positioning of this particular case allows us to recover our costs from a decades long legal process, creating an additional cash tailwind for Dow in 2025. Next, I'll share some details on the actions we've outlined in our last two earnings calls.

Moving to slide three. At our fourth quarter earnings call, we announced an additional $1 billion dollars in targeted cost actions focused in areas like productivity, third-party spending, and a reduction in approximately 1,500 Dow roles.

Now, we're making really good progress and expected to deliver $300 million of benefit in 2025, and expect to have full implementation in 2026. Now, this builds on our 2023 $1 billion-dollar cost reduction program, which included a structural reduction of approximately 2,000 Dow roles at that time.

Together, combined, these programs will result in a nearly 10 percent Dow workforce reduction compared to year-end 2022. In addition, we remain committed to continuously reviewing our asset footprint and matching supply to profitable demand.

Doing so is consistent with our best-owner mindset, which you've heard us talk about quite often and has led to more than 20 asset actions since 2023. Now, this includes shutting down our propylene oxide unit in Freeport, Texas in the second half of this year to reduce lower-value merchant PO derivative exposure.

We plan to provide decisions from our strategic review of our select European assets at our first quarter earnings call in April. Now, collectively, these asset actions represent things that must be done at the bottom of the cycle. Because when demand picks up, and which it will, Dow will be well-positioned to achieve higher earnings from the improved cost competitiveness.

Now, to support the near-term cash flow, we have also recalibrated our CapEx deployment by reducing our planned 2025 spending by $300 to $500 million compared to our previously disclosed target of $3.5 billion. We'll keep our CapEx spending roughly at these levels until we see clear recovery materialize across broad portions of the end markets that we serve.

Finally, our signed agreement with Macquarie Asset Management, which is expected to close in the second quarter of this year, is consistent with our track record of delivering unique-to-Dow cash flow levers to mitigate cyclical volatility.

Now, we expect to generate approximately $2.4 billion of initial cash proceeds, and Macquarie Asset Management has the option to increase their minority equity stake to 49 percent within six months of closing, which would increase the total cash proceeds to approximately $3 billion for Dow if exercised.

Now, our collective action support Dow strong relative performance. As you can see on the right of the slide, despite continued macro weakness and our unplanned events in 2024, Dow was able to outperform our competition in both three-year average operating EBITDA margin at a company level, as well as on a per pound of polyolefin capacity at a Packaging & Specialty Plastic segment level.

Now, this is enabled by our cost advantage footprint in the Americas and our on purpose built feedstock flexibility around the globe. These were some of the bright spots in the portfolio, but there were also areas where we continued to face pressure. Notably those exposed to key end-markets like durable goods, automotive as well as building and construction.

Now, we'll share more at our first quarter earnings call when we publish our annual benchmarking report. Moving to the next slide, from a macroeconomic perspective, demand remains soft. The economic deceleration that began in the second half of last year across most regions, as well as in markets, is persisting into the first quarter with no signs of inflection, at least through February.

Global manufacturing PMI remains stable around 50, 5-0, but was in contractionary territory for five of the last eight months. In addition, the housing market continues to disappoint both in the U.S. as well as China.

Now, we're also monitoring the impacts of a re acceleration of inflation and the potential for tariffs on consumer confidence, which recently saw its largest drop in the U.S. since August of 2021. Now, the reality is our industry continues to experience margin pressure globally, which is largely driven by higher energy and feedstock costs in both the U.S., Gulf Coast, as well as Europe.

The elevated levels of feedstock and energy are persisting throughout the quarter, contrary to our initial guide expectations. The price increases we've announced for March are necessary to offset the continued pressure from input costs, while providing high quality products and services to our customers.

In addition, the first quarter guidance that we shared in January did not include any impact from recent winter storms in the U.S. Gulf Coast, primarily Enzo. While we managed the storms operationally well and had no major asset impacts, we did proactively take units down through the storm. As a result, we lost some production time.

Now, this will drive an approximately $50 million, 5-0, negative impact to EBITDA in the quarter. As a reminder, March has historically represented an outsized portion of Dow's first quarter earnings. Our quarterly performance will be largely driven by this month.

As we continue to monitor these macro indicators, we're focused on leveraging our cost advantage position and diverse portfolio to capture areas of near-term demand strength in the quarter. Closing on slide five, our strategic priorities for 2025 are consistent and clear.

As we navigate a challenging macroeconomic environment, we remain committed to our capital allocation priorities. The unique-to-Dow cash flow levers that we're delivering and that I mentioned earlier, help to further strengthen Dow's financial flexibility.

At the same time, we continue to take proactive, strategic actions to optimize our global footprint, especially in higher cost Europe. Construction at our Path to Zero project in Alberta remains on track and on budget. This project is being built at an existing DOW site in a significantly cost advantaged region.

When completed, it's expected to deliver an additional billion dollars in incremental EBITDA annually at full run rates. With returns on invested capital in line are better than our Texas-9 project. We also anticipate over $1.5 billion in cash and tax incentives from government support.

Importantly, we have not the built a potential upside we anticipate from commercializing low-to-zero emissions products into the project financials. Now, this is something we're actively negotiating with customers and we'll share additional updates when we're able to.

Finally, we'll complete several of our near term growth investments this year. For example, this quarter, the plant maintenance activity at our ethylene oxide asset in Texas will enable the start-up of additional alkoxylation capacity in the U.S. Gulf Coast.

Looking ahead to the remainder of the year, we remain focused on navigating these near-term headwinds while advancing Dow strategic priorities. With that, Jeff, I'm happy to take your questions.

Jeff Zekauskas: Thanks very much. There's a lot in your slides. Maybe the place to begin is the NOVA decision. In listening to your commentary, it seemed that there were two features. That is, the award amount, which is confidential, is higher than you expected. Then there was also a legal expense reimbursement dimension. Is that fair, in that both numbers are meaningful numbers?

Jeff Tate: In short, that is fair, Jeff. I would say that that's accurate. As I mentioned in the comments, we'll definitely have more to share as the calculations get fine-tuned. Based on the initial confidential data that has been received, it will be well above the initial numbers that we've shared in the past.

Jeff Zekauskas: But not more than $1 billion.

Jeff Tate: More to come on that.

Jeff Zekauskas: Oh. It's an open question.

Jeff Tate: More to come on that.

Jeff Zekauskas: All right. The second thing is you're thinking through your asset footprint in Europe. I think you said that you're making some initial decisions or initial assessments in the March quarter. Then, in the second quarter, you'll have more definitive things to say. Can you unpack that a little bit for us?

Jeff Tate: Sure. Thanks for bringing that up, Jeff. For us, one of the things that we've been talking about, going back to third quarter of last year, is really doing an overall evaluation of Europe. When you think about Europe, from our vantage point, Europe is 20 percent below pre-COVID levels, as it stands right now, 20 percent below...

Jeff Zekauskas: From a volume standpoint.

Jeff Tate: from a volume standpoint. When we look at energy consumption for Europe, comparing to the average of 2019 through 2021, about 20 to 25 percent below on energy consumption. When we look at the energy cost, at least four to five times higher than U.S., North American energy cost.

With a number of those structural challenges that we face, the industry faces, looking at, right now, continued softness and demand overall and some of those overall structural challenges, we feel it's prudent to take actions around our footprint in Europe because we don't see that recovering anytime soon.

One of the things that we have said, coming out of our third quarter earnings call, is that we would definitely look at our overall strategic review, especially at more commoditized products that are especially and particularly energy-intensive, for a number of those reasons that I just shared.

When you think about the portfolio and the businesses that would really fit that criteria, you think of Polyurethanes in particular. We've also had some discussions around our siloxanes options as well in Europe. If you think about what's in scope, I would say that fits the criteria overall of what we're looking at, those things that are more commoditized and energy-intensive.

We also get the follow-up question around, "Is olefins and Packaging & Specialty Plastics, part of that?" It's not directly in scope, but you've also seen, from our last quarter earnings call, that we did highlight the decision we've made around Terneuzen-3.

Because we have a shutdown that was planned, we've been able to idle that plant and that asset to be able to avoid those turnaround costs as well but still be able to supply our customers from the existing asset base in Europe.

What we will share in our April earnings call will be an update on where we stand with our European decisions. We will announce some decisions at that time. We will also provide another update at our second quarter earnings call mid-year.

Jeff Zekauskas: The language that you have in your slide is that you're going to discuss the right-sizing of the high-cost parts of footprint. It sounds like, initially, you're going to say, "Maybe we need to be smaller in these particular areas." Then, in the second quarter, it's "Of the things we have, what should we keep and what should we separate?" Is that the idea?

Jeff Tate: There will be incremental updates of the decisions, based on, again, the criteria that I just shared, that shows the progress we're making through each phase of the decision-making related to those projects. Again, more commoditized, energy-intensive and those that will allow us to still tighten the rationalizations.

If you think about it as well, Jeff, there has been 10 percent of Western Europe rationalization announcements already on the C2 side. With that, I think you're going to start to see things continue to consolidate. We're going to do our part in those areas that, again, help to improve our earnings.

Jeff Zekauskas: Of course, Lyondell is exiting...Not exiting. They're downsizing their presence in Europe or thinking through their asset base. We've seen ExxonMobil make decisions. We've seen Shell make some decisions.

Why do you think that this is not just cyclical weakness but is more of a structural event for the industry where it feels that it really needs to take steps? Is it the demand side or the regulatory side?

Jeff Tate: I definitely think, again, the consumer demand and the softness, it's been prolonged for quite some time. I think you've got the geopolitical uncertainty that has obviously affected the higher energy costs that we discussed earlier. You look at some of the regulatory challenges of having so many different regulatory bodies, which makes the overall global competitiveness tough in that region.

I think when you don't see a tailwind that would say that things are going to sizably and significantly improve in the near-term, most of us are looking at what that could mean in terms of our asset footprint, while still being able to supply across the region.

For example, for us, if you look at our Terneuzen and Tarragona assets, those are still top quartile in the region. We will continue to take advantage of that in our Packaging & Specialty Plastics, space.

Jeff Zekauskas: You made a comment about your siloxanes operation in Europe. Can you tell us a little bit on the size or the positioning of that asset and why you may be rethinking your position there?

Jeff Tate: When we look at our overall Silicones and siloxanes business and you think about the global nature of it, Silicones, for us, we are heavily focused on investing downstream because there's higher margin opportunity, obviously, from a silicones perspective. We're the largest silicone producer.

If you look over the past several years, from a siloxane standpoint, upstream, there's been a sizable amount of capacity that's come online, especially out of Asia and China. We've seen that start to slow down, in terms of that new capacity and the pace of that new capacity.

What we're looking to do is to do our part by investing in more silicones to absorb some of that additional capacity. As the pace of those additional capacity slows down and we look to rationalize in certain areas like our operation over in Europe, that will allow the operating rates to continue to tighten up.

Jeff Zekauskas: You mentioned the Macquarie venture. I couldn't tell whether there was something that was new. That is, I think that Macquarie, the idea was that they could spend $2.4 billion. There would be an option that could take them up to $3 billion. Is that a reiteration of what's gone before, or is there a new element?

Jeff Tate: I would say that the biggest new element is the outlook that we will close the transaction in the second quarter...

Jeff Zekauskas: In the second quarter.

Jeff Tate: for that initial phase which would be that $2.4 billion, which then positions to be able to look at the option on the additional nine percent. That could bring in another $600 million before year end of 2025.

Jeff Zekauskas: Do we know the EBITDA effects on the $2.4 billion? That is how much EBITDA you lose from putting the assets into the venture.

Jeff Tate: Yeah, it will be consolidated from that vantage point. You'll see most of the impact coming more on the EPS line from a financial statement perspective. We'll share more about that once the deal closes.

Jeff Zekauskas: Again, I think there are a couple of more things that were in your slides. What you said was that there was $50 million of increased hurricane costs. If I remember, maybe the fourth quarter EBITDA was $1.2 billion. Maybe there was a $200 million deduction from various events. Now there's another 50.

Where we are now is, we're about 950 for the first quarter, plus or minus a little bit or depending on the nature of March, right?

Jeff Tate: Correct. That's fair. If you recall when we came out with our first quarter guide, we also talked about, there would be higher turnaround span from fourth quarter to first quarter as well. Again, we did not at that time know about the impact of Enzo. We wanted to provide that update of right now, approximately $50 million.

Jeff Zekauskas: Then I think almost lastly your CapEx will be lower, and I think you said $300 to $500 million lower, so call it $400 million. I think your CapEx was $3.0 billion to $3.2 billion for this year, so that's $3.1 billion. Where like $2.6 billion or $2.7 billion for 2025. Is that...?

[crosstalk]

Jeff Tate: No. If you look at our initial guide for CapEx was $3.5 billion.

Jeff Zekauskas: It was $3.5 billion.

Jeff Tate: It was $3.5 billion. We're saying now that we're going to recalibrate that to a lower number of $300 million to $500 million. Let's call it $400 million. That would get you in the $3.1 billion range versus the $2.9 billion that we had in 2024.

Jeff Zekauskas: In your remarks, Jeff, you talked about what isn't included in the possibilities of the Alberta project. That is, you're going to make a premium product and you talked about being in negotiations with your customers. Can you talk about this premium or opportunity that's not included in your returns right now?

Jeff Tate: Absolutely. First of all, I would say that the conversations with our customers are going extremely well. In terms of, they recognize because one of the questions, Jeff, that we tend to get is because we're in this political environment that we're in today, are you seeing customers maybe slowdown in that space?

The short answer is no, because most of our customers, when they look across their value chain, they're making these ambitious commitments for decades long. They're looking out 2040. They're looking out 2050, 2030, and beyond. With their commitments around that ambition, they recognize that Dow will have a first mover advantage by being able to provide this product.

At a minimum, what we shared publicly is that you're talking maybe greater than $100 per ton, premium that could be here, but we have not included that in the project financials, as I mentioned earlier. Right now we're assuming without that, that the project would have a return in the 15 plus percent range, which is similar to what we have for Texas-9 on the U.S. Gulf Coast.

Jeff Zekauskas: The reason why it would receive a premium has to do with its lower carbon output. Is that correct?

Jeff Tate: That's correct.

Jeff Zekauskas: Are there particular credits that can be calculated that the users of this product would receive?

Jeff Tate: There will be, and that's one of the opportunities that we see in the industry is, how will those credits be, from a standardized perspective, calculated so that there's consistency across the industry, which is why we've been a strong proponent of having this carbon footprint ledger that can make sure that there is some consistency and standardization around how that's calculated.

Jeff Zekauskas: In your negotiations with potential customers are these the end users? Are these companies like Pepsi, or Coke, or rather than a company like Berry, or Amcor, or somebody who's in the middle?

Jeff Tate: I would describe them as fast-moving consumer brands.

Jeff Zekauskas: Fast-moving consumer brands. One of your competitors has a product, and what they do is they take plastics and they melt them down and reduce them to a product, and then they will eventually make polyethylene from this, and it has a lower carbon footprint. In the world of competition, is your zero-carbon product a competing product to MoReTec or something like that, or is it a different product?

Jeff Tate: I'm not sure to speak on the other competitor's product, obviously, but from our vantage point, again, we see the timing of our Alberta Path2Zero project as being a first-mover advantage opportunity for us with low to zero-carbon emissions, which gives us, we see, a tremendous outlook here for the customer base.

Jeff Zekauskas: You're in Western Canada. Do you have ideas about detaching the carbon credits from the physical product? I would imagine Western Canadian polyethylene goes to Asia, but maybe that's not the place where the carbon credits go. How does that work?

Jeff Tate: It'll be interesting to see, but that's part of this whole carbon standardization when you look at the carbon credit ledger, because we see it as an opportunity when you've got such a broad network, like we have from a olefins perspective, that you may be able to produce it in Alberta, Canada, but you may necessarily source it from a different location. That's all to be better-defined as we get this ledger in place.

Jeff Zekauskas: Is the real target market for that product or for those credits Europe or the United States?

Jeff Tate: I would say when we look at where we've traditionally had a lot of the product out of our existing asset base in Alberta, that a lot of that has been exported to Asia.

Jeff Zekauskas: The credits, do they go to the U.S. or Europe? Where are you focusing there?

Jeff Tate: We haven't necessarily discussed that broadly yet, but more to come in that space.

Jeff Zekauskas: More to come. Jeff, there have been proposed tariffs. The first thing, now that you're investing the money in Alberta, does the tariff discussion change the way you think about the Alberta project?

Jeff Tate: No. We see the Alberta project standing on its own in terms of the investment thesis, Jeff, because if we think about the ethane advantage that we have in Canada, even with our existing asset base, we're building this complex at an existing Dow site. There will be tremendous infrastructure savings that we'll get from that vantage point.

Again, looking at the product and the first-mover advantage, all those things fit well with our ability to be able to take our conversion cost advantage from Texas-9, take the advantages around the ethane, being able to utilize that to source around the world provides a significant opportunity for us.

On the tariffs side, we're looking at the first phase is 2027. Who knows where we'll be from a tariff environment perspective at that point. I will say, as we think about today, and our existing asset base, and wherever the tariff discussions land, our intentions is to ensure that we are making sure that our price increases reflect those tariff impacts, along with higher energy and feedstock cost impacts as well.

There are multiple dynamics to the pricing activity and the pricing strategy that we have. While, at the same time, since the US elections, our teams have been doing a tremendous job of scenario planning, in terms of logistics, looking at our sourcing capabilities, as well as taking advantage of the broad network we have around the globe to be able to source as much locally as we possibly can.

At the end of the day, our intent is to try to make sure this is as much of a zero-impact gain as it can be, ultimately, no matter how the tariff situation plays out.

Jeff Zekauskas: With the different announcements and tariffs that have been made, has Dow made different decisions about changing the flows of its products?

Jeff Tate: Short answer is no, not at this point.

[crosstalk]

Jeff Tate: Again, we are very well-prepared to manage through that once we see what ultimately gets implemented.

Jeff Zekauskas: The thing about the Alberta project is you'll spend, roughly, with your regular CapEx, you'll spend, I don't know, $3 billion a year in CapEx, and you've got a couple of billion in dividend payments. That's a significant draw on cash flow. What you've done is you'll have some NOVA proceeds, you'll have some Macquarie proceeds. Are there other steps or other levers that you might pull over the next several years, or are we done?

Jeff Tate: We're never done. I would definitely say that we continue to look across our portfolio, whether it's wholly-owned assets, as well as looking across our joint ventures as well. We've talked about consistently delivering, on average, $1 billion dollars of unique-to-Dow cash flow levers.

That's the commitment that we'll continue to make. When you look at what we just discussed earlier in my prepared remarks between the NOVA judgment as well the Macquarie impact, you're looking at well over probably $3.5 billion of cash tailwinds that we will deliver in 2025 alone.

To your earlier point, when you look at our CapEx, you look at our dividend, and I want it to be crystal-clear, for us, and I mentioned this in my opening comments, our dividend is important to our owners. We recognize and appreciate that, and our dividend is very important to us as a management team.

We remain committed to our dividend moving forward. With these cash flow levers that I just highlighted, as well as our solid balance sheet and where we stand from a liquidity perspective, we're in a good position to be able to support our dividend for the next several years.

Jeff Zekauskas: The dividend is really the foundation of the Dow value proposition with its shareholders.

Jeff Tate: In addition to obviously operating safe and reliable operations.

Jeff Zekauskas: Dow has different ideas about its cash flow relative to its Operating EBITDA, in that historically, it's been a priority to have a relatively high ratio. Is there a target? Do you want to be at 80 percent or 70 percent? Where do we stand in 2025, in terms of puts and takes?

Jeff Tate: Sure. The average that we would state over an economic cycle, Jeff, is for us to be in that 80 percent.

Jeff Zekauskas: 80 percent.

Jeff Tate: 80 percent range on average. For us, I would say the target in 2025 would more than likely be in that 70-plus percent range.

Jeff Zekauskas: Dow has always had very capable people procuring energy and feed stocks for them. I'm interested in their opinions these days, in that when I look out at the projects that are planned, I see Lyondell wanting to build things in joint ventures in Saudi Arabia.

I see you building things in Western Canada. What I don't see is I don't see any more projects in the U.S.. I get it, there's the Qatari project that's coming up with CP Chem, but when you take a step back, it certainly seems that oil demand in China has slowed.

There are all kinds of ideas about the U.S. exporting natural gas and different data centers being built and that being a pull on gas demand. Do you think that we've come to the twilight of the United States as an advantaged place to build integrated plastics? It's not bad, but maybe it's peaked. Would you agree, or what do your Dow people say about that?

Jeff Tate: I would say this, Jeff, when we look at our portfolio, 75 percent of our wholly owned Polyethylene and Ethylene footprint is in the Americas. You think about U.S. Gulf Coast, Canada, and Argentina, and out of that 75 percent, the large majority is in the US.

Our project Gulfstream, our Texas-9 project in that fleet, came online in 2017. We're still fairly new with some of those assets that are our best-run, top quartile, first quartile from a cost position perspective. Our team is very proud of those assets and those investments that we made.

I know you've been covering the industry and us for a long time. We invested in that cyclically. Very similar to what we're doing right now with Alberta as well, because we positioned, and the team did a good job of positioning us and understanding what the outlook could be.

We don't see there being a "twilight" on America and the manufacturing and the build in that space. In fact, we see it as more opportunity, which is why we still feel very constructive around our packaging, especially plastics and our ethylene chain coming out of the Americas. Again, having 75 percent of our footprint in that base positions us really well.

Jeff Zekauskas: From your point of view, you've pivoted a little bit to Canada, but maybe down the road, what you'll do is you'll return to expansion possibilities in the United States.

Jeff Tate: What we'll do is we'll continue to look at our assets and where they are from an end-of-life perspective and ensure that as we make replacements, that it's going to put us in a better-advantaged position from a cost standpoint.

Jeff Zekauskas: Thanks very much, Jeff, for our discussion. Thanks very much.

Jeff Tate: Thank you, Jeff.

Jeff Zekauskas: Thank you.

[applause]