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# EDITED TRANSCRIPT

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## PRESENTATION

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

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

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

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

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

On Slide 2, you'll see our agenda for the call. Jim will start with an overview of Dow's third quarter and operating segment performance. Howard will then move into a financial overview of the quarter and will also provide some comments on modeling guidance and discuss Dow's progress against some of our key financial targets. And finally, Jim will provide a progress update on Dow's costs and growth targets and then close with a discussion on our forward-looking views. Following that, there will be plenty of time for your questions.

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

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

Thanks, Neal, and thanks, everyone, for joining us this morning. Starting on Slide 3, our results in the third quarter demonstrate the Dow team's focus on managing the levers within our control while also making progress against our operational, financial and strategic priorities that we laid out for the new Dow at our Investor Day last year. At that time, we presented a clear set of priorities and targets along with a playbook to drive our execution. Since then, we have been diligently delivering on that plan.

In the third quarter, we achieved top line performance that was in line with our guidance and bottom line results that exceeded expectations. In doing so, we delivered strong improvements from Q2 to Q3 across the board, EBIT margin, earnings and free cash flow. Here are some other notable highlights from our results.

First, we continued to capture demand growth, particularly in sectors closer to the consumer where conditions remain favorable. Excluding Hydrocarbons & Energy, Dow's volume rose by 1% in the quarter led by consumer growth in packaging, polyurethanes and silicones application.

Second, we grew earnings and margins sequentially, led by our plastics franchise. We leveraged our industry-leading feedstock flexibility in the United States and Europe. In Europe, we capitalized on the LPG advantage versus naphtha. And on the U.S. Gulf Coast, we made full use of new butane capabilities that we put in place earlier this year. And we successfully achieved 0 naphtha cracking this quarter, expanding our flexibility and avoiding an otherwise costly feedstock penalty. Additionally, we focused on recapturing price, a key improvement toward the end of the quarter in polyethylene.

Third, we continued to drive down our cost structure. We reached a significant milestone in the quarter, successfully completing our \$1.365 billion cost synergy program. Furthermore, we removed another \$40 million of stranded costs in the quarter.

And fourth, our results this quarter showed the ability of Dow's portfolio to generate strong cash flow. We generated \$1.8 billion in cash flow from continuing operations and \$1.3 billion in free cash flow. We improved our earnings to cash flow conversion as well as working capital improvements provided a source of cash. The cash flow story this quarter is a noteworthy highlight and Howard will unpack this later in the call. We accomplished all of this while navigating a business environment with limited visibility and while overcoming operational limitations in Argentina, where both of our crackers were down through the third quarter following a countrywide power outage in late June.

And finally, we made important progress in our litigation with Nova Chemicals and in our deleveraging priorities. In September, a judgment was entered in Alberta, Canada ordering Nova Chemicals to pay Dow approximately \$1.1 billion. On October 10, Dow received the related cash payment of approximately \$800 million. Subsequently, we issued a make whole call for the full redemption of \$1.25 billion of notes due in 2021, further reducing debt. This was another important step forward in strengthening our financial profile.

Altogether, our results demonstrate the strengths of the Dow portfolio and our continued focus on executing the operational, financial and strategic playbook that we laid out a year ago. Now moving on to our segment results and the business performance in the quarter.

On Slide 4, Packaging & Specialty Plastics expanded operating EBIT margin nearly 200 basis points year-over-year. Our results reflected demand growth in packaging applications, margin expansion, cost synergies and contributions from new capacity on the U.S. Gulf Coast which more than offset lower equity earnings. And notably on a sequential basis, EBIT grew 4% and operating EBIT margin expanded 100 basis points. Further, the results are particularly notable considering that the segment overcame a \$100 million headwind from a combination of lost ethylene production and repair costs in Argentina. Our 2 crackers there are now back up and running.

In the third quarter, we saw a continuation of solid demand in packaging application. The Packaging & Specialty Plastics business grew volume by 4% year-over-year. We again saw growth in Industrial & Consumer Packaging, Flexible Food & Specialty Packaging and health and hygiene application. Regionally, volume growth this quarter was led by Asia-Pacific and EMEA. In Hydrocarbons & Energy, the business reported both lower volume and local price. The volume declines were an outcome of our drive for lighter feedstocks in Europe which led to lower coproduct production volume. In addition, we had slightly lower merchant ethylene sales in the United States



as a result of enhanced ethylene integration enabled by our new derivative capacity.

On Slide 5, Industrial Intermediates & Infrastructure operating EBIT decline versus the year-ago period primarily due to margin compression in the polyurethanes component and MEG as well as lower demand in industrial end markets.

In Industrial Solutions, volume declined modestly as a result of lower demand in energy, agriculture and automotive end markets. This was partly offset by growth in catalyst application and demand in pharma end markets. The business reported a significant drop in its equity earnings driven by margin compression for MEG at our Kuwait joint ventures.

Polyurethanes & Construction Chemicals sales declined on lower local pricing in all regions led by lower components prices. However, the business achieved volume growth driven by gains in the United States and Canada on improved MDI supply year-over-year as well as continued demand growth in polyurethane systems.

Our growth in Systems reflects the business' focus on driving its downstream agenda and moving the portfolio from merchant component sales to higher-value formulated systems. It has been a multiyear journey and the progress we've made so far has been impressive. This quarter marked the 25th consecutive quarter of year-over-year volume growth for the Systems business.

And finally on Slide 6. Performance Materials & Coatings operating EBIT fell from the year-ago period primarily due to siloxanes margin compression and lower demand in coatings and monomers.

Consumer Solutions sales declined as volume gains in Asia-Pacific and the U.S. and Canada were more than offset by local price declines in all regions mainly driven by lower siloxanes prices. The business reported volume growth in infrastructure end markets and improved demand for siloxanes in Asia-Pacific. This was partly offset by soft demand in the automotive and consumer electronics end markets.

Coatings & Performance Monomers reported a volume decline. On the coatings side, the business saw lower demand in the U.S. and Canada in architectural coating and soft demand in Asia-Pacific in industrial coatings end markets.

I'll now turn it over to Howard to discuss our financial performance in the quarter, modeling guidance and the progress that we made against some of our key financial targets.

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

Thanks, Jim, and good morning, everyone. Turning to Slide 7. Net sales were \$10.8 billion, in line with our guidance. The decline was primarily driven by lower local pricing. Volume declined 2% year-over-year. This was largely driven by changes in Hydrocarbons & Energy related to our cracker feedstocks combined with lower ethylene trade sales volume. Excluding Hydrocarbons & Energy, volume was up 1% versus the year-ago period driven by growth in packaging, polyurethanes and silicones applications.

Sequentially, demand was higher in Packaging & Specialty Plastics and in Industrial Intermediates & Infrastructure. Local price declined 12% primarily due to decreases in lower global energy prices year-over-year. Currency decreased sales by 1% as a result of the strengthening of the U.S. dollar against the euro. The earnings impact of currency was offset by year-over-year tailwinds from a lower tax rate and reduced interest expense.

Equity losses were \$44 million, a year-over-year headwind of nearly \$180 million. The decrease was primarily due to lower results at the Kuwait joint ventures driven by margin compression in MEG and polyethylene. Equity losses at Sadara also increased primarily due to the impact of a third-party industrial gas supplier issue which has since been resolved. In the appendix of our earnings deck, we have included our additional disclosure for our 3 principal joint ventures which provides further details on their results.

Overall, operating EBIT was \$1.1 billion. Tailwinds in the quarter included savings from cost synergies and stranded cost removal as well as contributions from new capacity on the U.S. Gulf Coast. These gains were more than offset by a year-over-year margin compression in siloxanes and isocyanates, lower equity earnings and the impact from the Argentina outage. On a sequential basis, operating EBIT rose 5% or nearly \$60 million, representing our first sequential EBIT increase in more than a year. Our operating EBIT margin also expanded



80 basis points led by margin expansion in Packaging & Specialty Plastics.

We generated \$1.8 billion of cash from continuing operations which reflected a reduced headwind from integration and separation spending and a \$700 million release of cash from working capital. Relative to the year-ago period, our cash from continuing operations was up \$1.6 billion. But recall that we made a voluntary pension contribution last year of \$1.1 billion. After adjusting for this, the underlying operation delivered a \$500 million increase in cash flow versus the same quarter last year.

And finally, we returned \$600 million to our owners in the quarter, including \$500 million of paid dividends and \$100 million of share repurchases. Since spin, we have completed \$400 million of share repurchases and we remain on track to achieve our target of \$500 million for the year.

Moving to Slide 8 and our modeling guidance for the fourth quarter. As we have for the past couple of quarters, we're again providing our segment guidance on a sequential basis to reflect the most relevant comparison in today's environment. At the total Dow level, we see core EBIT tailwinds sequentially as headwinds from normal fourth quarter seasonality in coatings and infrastructure markets and modest impacts from turnarounds are offset by nearly \$150 million of add-backs from onetime events in the third quarter, including the impact of our outage in Argentina.

In Performance Materials & Coatings, we expect siloxanes pricing to remain at about the same level as we exited the third quarter. In coatings and monomers, we expect to see the normal seasonal reduction in profitability and the business will also absorb 1/3 of the impact from our planned PDH turnaround that is currently underway.

Moving to Industrial Intermediates & Infrastructure. This segment will absorb the remainder of the PDH turnaround impact, and MEG prices on average are projected to be similar to the third quarter.

And finally, in the Packaging & Specialty Plastics segment, we see feedstock price trends continuing to drive lighter cracker feedslates in the U.S. and Europe which will continue to reduce our top line sales of coproducts. We expect a modest sequential headwind as we complete a large turnaround in The Netherlands, and we anticipate reduced catalyst and licensing earnings in the quarter, which by their nature are lumpy. On the positive side, our Argentina assets are now back online so they will once again be positively contributing to our results.

Turning to Slide 9. There are 2 areas where I'd like to highlight the progress we've made against our financial targets. The first is our capital structure, specifically the deleveraging and liability management we've done this year. As you'll recall from our Investor Day last year, we outlined our capital structure priorities and our deleveraging targets.

And as you see on this slide, we have been delivering on our plan, making significant progress in improving and smoothing our debt maturity profile and maintaining our liquidity position. We have opportunistically refinanced upcoming maturities and we secured the option to extend the outstanding \$2 billion on our term loan by an additional 2 years to the second half of 2023. So far this year, we have completed \$2 billion of gross deleveraging. And with our recent \$1.25 billion debt redemption announcement which was supported by the cash proceeds we received from Nova, we will complete more than \$3 billion of gross deleveraging by the end of this year.

The result of these actions is that we do not have a significant debt maturity due until 2022 and we have maintained our strong liquidity position, which is more than \$10 billion. These accomplishments align to the financial priorities we outlined a year ago: Maintaining a strong capital structure, reducing risk, lowering interest expense and preserving our financial strength and flexibility.

Moving to Slide 10. The second financial highlight is the progress we have made in our cash flow generation and the potential we see to improve further from here. Looking at the trailing 12 months, we have delivered \$3.2 billion of free cash flow, but our results do not yet fully reflect our underlying potential. The reason for this, as we highlighted at the start of the year, is that we have had short-term cash headwinds from 2 discrete factors: Post-spin integration and separation activities and interest expense. On both fronts, peak spending is behind us.



Through the third quarter, we have spent more than \$1 billion on integration and separation spending in 2019 and we expect the full year spend to be in the range of \$1.2 billion, in line with our target for the year. This spending is beginning to recede. And looking ahead, we expect the 2020 cash spend to be in the range of \$200 million to \$300 million or a year-over-year release of cash of about \$1 billion.

And on interest expense, as I highlighted, we have accomplished a substantial amount of deleveraging and liability management. This has put us in a position today where we see our 2020 run rate interest expense being \$100 million lower than where we started in 2019. These 2 factors alone represent more than \$1 billion of cash flow uplift in 2020 that are completely within our control and independent of market conditions.

We also continue to pursue nonoperational cash inflows, notably the additional litigation we have pending with Nova, and our teams continue to also focus on operational improvements such as greater working capital efficiency. These improvements will not only boost gross cash flow but should also lift our earnings to cash conversion.

Our focus on cash is paying off, and all other things equal, our free cash flow is poised to expand. This additional flexibility preserves our ability to deliver against our financial priorities, including our strong shareholder returns and further deleveraging.

Now I'd like to hand it back to Jim to discuss our progress on our cost and growth priorities as well as our near-term outlook.

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

Thanks, Howard. Turning to Slide 11. I'll start with our cost-out priorities.

The progress we've made on our cost reductions has been proceeding faster than we planned. In the third quarter, we successfully completed our \$1.365 billion cost synergy program which we finished about 1 to 2 quarters ahead of schedule. On the stranded cost removal side, we eliminated an additional \$40 million and have already exceeded \$125 million in cumulative savings.

Just before our spin, we laid out a target to deliver \$600 million of our remaining \$800 million of cost synergy savings and stranded cost removal in 2019. Based on the progress we've made through the third quarter, we now expect to deliver approximately \$700 million of savings this year with the remaining \$100 million to be realized in the first half of 2020. The Dow team has done an excellent job in putting together a robust cost-out plan that identifies, delivers and tracks these savings, and they have kept up that focus for more than 2 years to ensure our steady delivery against our target.

Turning to Slide 12 and perhaps what I'm most proud of is that the Dow story has not only been about cost, but we've also continued to drive several high-return growth projects. A year ago, we told you that the new Dow has a well-defined growth roadmap that includes a robust pipeline of attractive investment, projects that are lower-risk, faster-payback, lower capital intensity and higher return on invested capital. As the macro environment changed, we quickly adjusted our capital spending target for the year to \$2 billion and we intensified our criteria for approving and advancing projects.

In the third quarter alone, we advanced several projects. We announced the retrofit of one of our crackers in Louisiana with our proprietary fluidized catalytic dehydrogenation technology to produce on-purpose propylene. We see the FCDh technology as a game-changer for the industry. It promises reduced capital intensity, lower energy usage and lower greenhouse gas emission. FCDh not only drives return on invested capital benefits but it also advances our sustainability agenda when compared to all conventional PDH technologies.

We launched AGILITY CE, a new resin made with 70% post-consumer recycled plastics, which incorporates recycled plastic shrink film into low-density polyethylene.

We also announced 2 partnerships that showcase circular economy solutions for plastics: The Fuenix agreement allows Dow to incorporate recycled plastic waste back into our feedstock supply; and second, the UPM Biofuels technology enables plastic solutions made from bio-based renewable feedstock. Both solutions reduce carbon emission without impacting the performance of our final products.



In our silicones franchise, we continued to greenlight incremental debottlenecks. Through the third quarter, we have completed 14 of the 18 downstream capacity expansions that we planned for this year. We reached the final investment decision for our previously announced flexible alkoxylation capacity to support our customers' growth in infrastructure and home and personal care end markets. This U.S. Gulf Coast unit is expected to start up by the end of 2021. And furthermore, we recently signed a 10-year supply agreement with a key customer, securing the baseload volume for this facility, representing \$900 million of new revenue over the life of the contract.

And on the digital front, we launched a new Dow.com, featuring an expanded e-commerce platform. Year-to-date, we have already achieved nearly \$3 billion of sales through this channel and we're just getting started. These are just a few of the investments that we believe will fuel our growth, deliver productivity improvements, enhance customer experience and further drive us toward our sustainability goals.

Turning to our market outlook on Slide 13. As we look around the globe at key commodity products, our view is that in many cases, the margin for high-cost producers has essentially been bouncing around the breakeven point for at least the past 2 quarters. On this slide, we showcase a few prime examples. In MEG, Asian spot spreads have been at or slightly below the breakeven point for most of the year. And there have been reports over the past 2 quarters of high-cost producers dialing back production. In MDI, we see spreads in Asia bouncing around the historic low point. And in ethylene, the high-cost producer margins are thin and projected to go to 0 while the ethylene margin for producers in the Americas remains healthy.

Our base case remains that the global economy will continue growing albeit at a slower pace. In that scenario, based on historical spreads in our products' chains, we see a floor to further margin deterioration and a good upside to normalized levels when fundamentals tighten. In this environment, Dow remains well positioned thanks to our competitive positions on the cost curve driven by our feedstock flexibility, our scale and significant presence in lower-cost regions such as Canada, Argentina and the U.S. Gulf Coast.

To sum it up on Slide 14, 2019 has been our year to successfully reintroduce a more focused, more streamlined Dow, execute our playbook and showcase our financial and capital discipline. We believe the results of our actions will continue to show in our earnings, deliver enhanced cash flows and preserve our financial strength.

As you've seen from us all year and especially in the third quarter, we are delivering as we promised. And as we look to the near-term future, our mindset does not change. The current business environment demands discipline, and that is why we'll continue to leverage our feedstock flexibility, advance our lower-risk, higher-return growth investments while staying in line with our \$2 billion capital expenditure target this year and continue driving a best-in-class reduced cost structure by delivering the remaining stranded cost removal.

In sum, the steps that we're taking today position us well to leverage increased value when the industrial economy rebounds.

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

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

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

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) We'll take our first caller, David Begleiter with Deutsche Bank.

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

Jim, good job on the cost side. Just looking at Q4, what should we expect for incremental cost savings and stranded cost removals in Q4 versus Q3?



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

David, thanks. In Q4, I think you're going to continue to see somewhere in the range of \$65 million to \$75 million come out in additional costs. Our stranded -- our synergy program is done, as we communicated. We had a \$300 million target for stranded costs. We're at \$125 million year-to-date. You'll see another \$75 million approximately come out and another \$100 million the first half of 2020. So I think that will get us out of the stranded cost removals. And then as Howard mentioned, we also see about \$100 million lower interest expense next year because of the work that we've done on debt restructuring.

**Operator**

All right. And our next question comes from the line of Jeff Zekauskas with JPMorgan.

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

On Slide 12, you talk about headwinds for the fourth quarter, which is the absence of a lumpy catalyst and licensing activity of \$85 million, which was in Packaging & Specialty Plastics. So I take it what that means is that in the quarter you just reported, there was an \$85 million benefit from licensing activity that was I guess a little bit unusual. And your sundry income after you make the adjustments was up \$100 million. What is that? And does that flow through to the individual segments? And if it does, where does it go?

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

Howard, do you want to touch on the polyethylene part? And then maybe we can also talk about what's happening with pricing and PE.

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

Yes. I would say on -- so on the sundry income side, Jeff, the third quarter was favorable but that was really due to improved ForEx hedging, and that goes to each of the segments proportionally. It really wasn't a licensing and catalyst thing. On the licensing and catalyst, I would just say your description is not where I would go. I would say it's -- the delta change from Q3 to Q4, we're expecting to be \$85 million. That was not the absolute number.

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

And Jeff, on the licensing, that was a Univation license that was granted, and I think that's the comment on the lumpy demand. And so Univation still continues to license technology as people are continuing to build polyethylene capacity.

I would say on PE, I think the thing to take away for fourth quarter is that we ended \$0.03 higher than the IHS integrated margin spreads in the third quarter. And you've got ethane prices at \$0.18 roughly a gallon versus what everybody had expected to be greater than \$0.40 a gallon. So I think as you look into fourth quarter, with demand good, with inventories down in the third quarter and with that pricing outlook, I think you should expect to see a decent plastics quarter.

**Operator**

We'll next go to Vincent Andrews with Morgan Stanley.

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

Could you maybe talk a little bit about MDI and silicones and sort of what you think is going to happen through fourth quarter and into next year? Are we just going to bounce around these levels? Can MDI volume continue to compound at a mid-single-digit rate? Or do we have to worry about that being a little bit lighter next year?

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

Thanks, Vince. MDI and -- I would say siloxanes versus silicones. MDI and siloxanes are bouncing around at pretty low levels, as you mentioned. And I would expect them to stay in there. A little bit of turn in the industrial side of the sector and in the auto side of the sector would put a pull there that would start to bring that back up, but haven't seen that yet.

With PMI really declining for the last 4 consecutive quarters, the big delta here is consumers then really pulling all the volume growth and industrial hasn't yet. But I do think with inventories being low, I don't see any speculative activity out there. And with downstream investments like in our Systems business downstream and our silicones business, which are both continuing to hold up well, that's going



to create a pull on that supply/demand balance. And with nothing new on the horizon, I think you're going to see some steady improvement.

We get a deal on trade -- if we get a Phase 1 trade deal, that'll obviously be a tailwind. And I think the industry's poised right now for a little tailwind.

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**Operator**

Next question will come from the line of Hassan Ahmed with Alembic Global.

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

Jim, a bit of an interesting sort of quarter. Obviously, we had this incident happen out in Saudi Arabia which I would imagine limited feedstock supply to a variety of producers out there and I would imagine Sadara as well. So could you comment on whether or not you guys saw any curtailments in feedstock supply? Has that normalized out in Sadara? And was there any Q3 negative impact from that? And any residual impact we should expect in Q4?

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

Thanks, Hassan. Great question. We saw limited reduction in feedstock supply. We were down about 20% for less than 2 weeks. So that wasn't the real drag on Sadara in the third quarter. The bigger drag was we had an industrial gas supplier that supplies into the complex that really had an outage that really cost us on the range of \$25 million, \$30 million on Sadara EBITDA, and I think that's the bigger impact. Sadara's running well right now. I don't see any long-term issue from that. And really good cooperation and response from Aramco, really solid response.

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**Operator**

Next question will come from the line of Christopher Parkinson with Crédit Suisse.

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

So when you just generally think about the Dow story and how it's evolved since the initial spin, what do you think are the 2 to 3 primary profit drivers as we enter 2020? Is it synergy capture, cost run rates, facility downtime changes, changes in equity earnings? If you could just help us conceptualize the key puts and takes from your perspective over the next 12 months, it would be greatly appreciated.

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

Chris, it's a good question. I think what we've tried to do in 2019 is to prepare ourselves and get ourselves on solid financial footing as a new company, and I believe we've done that. We had to get the costs out. We had to get our balance sheet in the right space. We had to make sure that, that industry-leading dividend that we put out there was protected. And I believe that we've done that.

I think we've positioned ourselves well for an upturn in the industrial economy. The consumer side of the business is doing great and the high-return projects that we've got for growth are really playing into that. So we don't have a demand problem right now. There's a little bit of supply/demand imbalance that we're working through on those commodities, and that's driven primarily by a slower industrial economy.

We see strong growth in Asia. So we're up double digits out there. We see good growth around the world. And with a little rebound in the industrial economy, you're going to see a demand pull on the chain that we haven't seen for 4 consecutive quarters. When that happens, I think you're going to see margin expansion and things are going to start to move up. Oil goes up a little bit -- and you see the industrial economy come back, that typically pulls oil price up. That would help, too.

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

And Chris, this is Howard. I would just add everything that Jim talked about really sums it up into a cash story for next year. When you think about the lower interest expense that Jim talked about of \$100 million, what I talked about in the prepared remarks of \$1 billion of cash coming out of restructuring costs from 2019 into 2020, it really is a cash flow generation story as we head into next year.



**Operator**

We'll take our next question from the line of Duffy Fischer with Barclays.

**Patrick Duffy Fischer Barclays Bank PLC, Research Division - Director & Senior Chemical Analyst**

Question just on the relative pricing of polyethylene in North America versus Asia, it's been quite favorable. But with still a little bit more polyethylene to come online in the U.S. and us having to be a bigger net exporter going forward, do you see anything structurally changing in the relative price between North America and Asia?

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

I don't think you'll see a dramatic change, Duffy. I think demand in Asia has been good. We were up double digits in Asia-Pacific and I think we're going to continue to see strong demand there. I think the supply/demand in North America, inventories went down 3% at the end of third quarter, about 176 million pounds, and price went up in September. So I think that tells you there's some underlying good demand pull that's out there. And I think we're going to continue to see that evolve that way.

**Operator**

We'll go to P.J. Juvekar with Citi.

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

It's amazing that you went to 0 naphtha. I assume that's more of a U.S. Gulf Coast comment. And assuming that, can you discuss your feedstock changes in Europe? And then I guess my question is, if more and more companies follow your lead and take out naphtha, what is the outlook for global naphtha? And does that sort of lower costs for Asian producers?

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

Good question, P.J. Yes, the 0 naphtha was a U.S. Gulf Coast component. And what that does is really it widens our feedstock flexibility, so it gives us another range of flexibility that we didn't have. And that was important this quarter because ethane was really low and also propane was low in the quarter. Propane being low meant we cracked pretty aggressively LPGs in Europe. And we think that we will continue to do that through fourth quarter and first quarter into next year. And sometimes in the wintertime, if gas prices tick up, you would see that might be limited a little bit. But the outlook for gas as we go into this winter and the inventories and the current prices mean that we're going to be cracking LPGs.

I don't know if the change that we have on cracking 0 naphtha in the Gulf Coast is going to have a big impact on naphtha cost to everyone else. I would say that in Asia, the naphtha crackers today are at about breakeven margins. And they've been there for -- especially the fourth-quartile producers have been there for the last couple of quarters. So I think that pressure is going to continue even if naphtha goes down. Naphtha probably would move more based on what happens with oil price.

**Operator**

And we'll go next to Jonas Oxgaard with Bernstein.

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

I'm a little bit confused about your comments about the strong demand in Asia. I think we had this discussion last quarter as well. I mean when you're talking about strong demand, you're talking about your own volumes, not the industry as a whole, right? And as a follow-up -- yes, go ahead.

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

Go ahead. Go ahead.

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

Well as a follow-up, I mean, you're a low-cost producer so your volumes should always be strong no matter what. From what we can tell from the industry magazines and et cetera, the demand in Asia has not been great lately. Well, lately meaning the last several months. So could you comment a little bit about the difference between you and the market as a whole?



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

I think the bulk of what we're moving in Asia is in food and flexible packaging and health and hygiene materials. We also move obviously some materials into ag films and some other Industrial & Consumer Packaging. The consumer packaging is holding up fine, the industrial's been a little bit slower. But our volumes have been good.

The consumer side has been a strong pull for us around the world and it was a very strong quarter for us in Asia. And having said that, with -- even with that demand, we saw prices up at the end of third quarter, up \$0.03 higher than the IHS integrated margin levels. So I think that's a combination of our own pricing activity as well as our ability to capture the spreads by the feedstock flexibility that we've got.

We're continuing to add products to the line to expand that consumer side and to address some of the challenges on a circular economy, so you saw AGILITY CE in there. And we've got a host of other recycle-ready products and things for the consumer side of the business that we think are going to continue to drive demand.

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**Operator**

And our next question comes from the line of Bob Koort with Goldman Sachs.

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

This is Dylan Campbell on for Bob. When I look at free cash flows, it was a very impressive quarter, particularly compared to I guess the last several quarters where it's about double that rate. Can you give kind of just the bridge on what drove that strength this quarter relative to the last couple of quarters?

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

Yes. I would say we saw -- in the second quarter, we also saw a couple \$200 million, \$300 million improvement on an apples-to-apples basis despite lower earnings. I would say this quarter, what drove the big \$500 million beat, and I'm looking at apples-to-apples so I'm taking out the voluntary pension contribution we made last year because if you do it on a pure reported basis, we were up \$1.6 billion. But on a plus \$500 million basis, it really was working capital release. So we've got everybody on the team really focused on improving working capital. That was the primary. And then the secondary was really the lower restructuring and spin out spending that we were talking about. But that's going to lead into the \$1 billion release in 2020 versus 2019. Those are the 2 big components.

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**Operator**

And next, we'll go to Arun Viswanathan with RBC Capital Markets.

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**Arun Shankar Viswanathan *RBC Capital Markets, LLC, Research Division - Analyst***

Just a couple of questions around cash flow and uses of cash flow. Could you rank-order your uses of cash flow I guess here? And maybe within the context of the recent Nova settlement as well as maybe within the context of your margin outlook, it looks you had really strong performance on margins this quarter. But just curious on if that's gone much lower just given the polyethylene outlook, how you'd allocate cash.

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

Go ahead.

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

Yes. So on the uses of cash this year on a full year basis, you're looking at about \$1.5 billion on cash tax and interest expense, you're looking at \$2 billion on CapEx, about \$1.2 billion on restructuring and then a dividend of \$2 billion and \$0.5 billion on Sadara. And that's kind of the makeup of the key pieces that get you on the uses of cash. Relative to the Nova proceeds, you saw that we announced right after, within 2 or 3 days of receiving the cash, we did the make whole call on the \$1.25 billion worth of bonds. So that just helps us to continue to improve our maturity profile and smooth it out, and it obviously will also help lower the interest expense going into next year.



**Operator**

And next, we'll go to John Roberts with UBS.

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

Do you think your coatings-related volumes were down more than the end coatings markets this quarter, or in line? And I think one of the businesses flagged for a potential strategic review because it was one of the most significant underperformers over the past couple of years.

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

I think, John, it was in line with architectural coatings demand. And I would say the one other thing I would throw in there is there have been a couple of customers in architectural coatings that had taken a little bit of business captive. So that has been a bit of a drag on it. The other thing is that industrial coatings demand has been down, and we had a fair amount of industrial coatings business in China and that China industrial demand has been down. But that's I think in line with the rest of the market.

We're continuing to work on the coatings business in terms of the business model. So you'll see that I talked about on the call, we've got a new Dow.com portal out there. One of the things we're going to be doing in coatings is taking advantage of that e-commerce capability to try to broaden out our reach into that market segment. And that's going to help us fill up some assets and get more of that coatings volume.

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**Operator**

The next question comes from the line of Steve Byrne with Bank of America.

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

Howard, you mentioned the \$0.5 billion to Sadara this year. Just wanted to get your outlook for 2020. And then if I could, just you mentioned the -- this \$1.4 billion cost synergy program is now complete. That program was conceptualized a couple of years ago. What do you think of that now? Is there more opportunity in actual synergies? Or are you assessing productivity opportunities given some of the sluggish end markets?

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

Yes. Look, on Sadara, I would say one of the things that we're working on with our partner, Saudi Aramco, is achieving project completion. We've got one last step, which is finalizing a rail agreement with the Saudi rail authority in Sadara. That's in its final stages. Our plan right now -- and I'll be in The Kingdom in the next couple of weeks. Our plan right now is to get PCD done before the end of the year. And then we'll be looking at negotiating with the lenders on reprofiling the debt. But I would say for modeling purposes, Steve, I would just use another \$500 million next year and then we'll have more to say as we get that refinancing done.

Jim, do you want to talk about productivity for next year or you want me take it?

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

Yes. I think we're always looking at productivity gains that we can make. We've hit our benchmark targets in terms of cost and structure and headcount that we've been trying to achieve. We're working on trying to get more productivity out of working capital. We're working on trying to get more productivity out of our maintenance dollars. We've done a lot on the digital aspect and what we can do with digital technology there, those are both going to be important. And we've done \$3 billion year-to-date on our e-commerce platform. We're looking to that for some growth in productivity as we move forward.

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**Operator**

Next, we'll go to Matthew Blair with Tudor, Pickering, Holt.

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**Matthew Robert Lovseth Blair Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research**

I thought the results in II&I were pretty good with the quarter-over-quarter improvement despite some pretty tough conditions in MEG as well as Asia MDI. I think you also called out that industrial gas supplier outage, too. Could you just walk through what got better in II&I in Q3 '19 versus of Q2 '19?

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

Matthew, we had a turnaround in Q2 that really brought things down, and so we did not have that turnaround expense in Q3. Otherwise, I would say the business volumes and the quality of the business has been good. The real drag on II&I in third quarter was equity earnings from the Kuwait joint ventures, and that was because of the margin spreads on MEG. Kuwait's still a low-cost producer for MEG and making good returns, but we haven't seen any demand pull to really bring that margin spread up on MEG. When that comes, I think you'll see the real quality of III show through.

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**Operator**

Your next question comes from the line of Frank Mitsch with Fermium Research.

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**Aziza Gazieva Fermium Research, LLC - VP of Equity Research**

It's Aziza on for Frank. Looking back at the Wave 2 incremental capacity addition you presented back during the pre-spin meetings, I was curious to get your latest thoughts on those projects, with particular interest on the 600 KTA PE expansion in the U.S. Gulf Coast.

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

Those projects are still underway. I think the 600 KTA solution PE incapacity will continue to go ahead. We had mentioned that we're going to take a look at the 450 KTA European expansion. I think with the demand right now in Europe and with the market outlook, we don't see a reason to push that forward to any final investment decision right now. Everything else on that list that we put forward is underway and on the timeline that we put forward. And we're continuing to look at some additional things like the alkoxylates flexible capacity that we announced on the call today.

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**Operator**

Next we'll go to Kevin McCarthy with Vertical Research Partners.

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

Jim, I thought you had impressive results in Packaging & Specialty Plastics, notwithstanding some pretty weak industry volumes for polyethylene. So I wanted to ask you about the latter. I think going back to your Investor Day, you had assessed polyethylene demand, a growth rate at 1.4x GDP. Year-to-date, it looks meaningfully negative in North America versus a growing economy. So can you speak to why that's happening? Do you see it as temporary or more lasting in nature? And will it have an effect on new capital investment and capacity across the industry?

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

I think a lot of what happened, Kevin, as new capacities came up is you saw some inventories build up and some product move out there. The demand obviously, with industrial slowing down on the industrial side, has been a little bit slower than what we'd anticipated. The consumer side has been continuing to perform well. And so I think with some of the pressures that are on in that industrial side, that's really been the thing that slowed the overall growth. And you're coming off of a very, very strong 2018.

And so I think you're going to continue to see that there's good balance in the supply/demand going forward. I don't think there's any reason to think there's been a fundamental change in the 1.4x GDP. Our outlook for GDP next year is still around 3% globally. And so I believe that you're going to continue to see about 4%, 4.5% type of growth rates out of polyethylene.

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**Operator**

And next, we'll go to Jim Sheehan with SunTrust.

**James Michael Sheehan *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst***

Can you comment on the more -- the supply/demand balance in silicones? Do you see that market as balanced right now? And do you expect capacity additions in 2020 to change that balance much?

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

Yes. If I can, Jim, I would just say on siloxanes, I think that's where the length in the market is today, in the siloxane upstream materials. On the silicone downstreams, the supply/demand balance is still fairly tight and there's a lot of growth in those downstream applications to continue. But on the upstream side, when you get into areas of big volume use, like for example large commercial buildings, big industrial builds, some of that has slowed down and taken a little bit of pressure off of siloxanes.

There's no new capacity coming on in siloxanes. We're working off a lot of capacity that got added in China over the last couple of years. And I think there's nothing on the horizon for the next 2 or 3 years in the siloxanes space. So it should continue to tighten from here. If the industrial economy picks up a bit and the building and construction picks up a bit, I think you'll see that will tighten things up.

**Operator**

And we'll take our last question from Laurence Alexander with Jefferies.

**Laurence Alexander *Jefferies LLC***

With respect to the investments in the circular economy and the discussions around various types of recycled waste inputs, are -- is that part of the industry mature enough for you to benchmark whether the returns on capital or the appeal of the projects is competitive or advantaged or disadvantaged against conventional petrochemical investments? Or is it still basically a subsidized research project?

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

Laurence, let me approach it this way. I think the real thing that's changed here is you're starting to get a sense that the pressure on the consumer goods companies from the consumers would indicate there's probably a change in people's willingness to pay for a more recyclable or sustainable product. And so I think that is probably the more important question than the cost of this versus virgin plastics from virgin natural gas liquids or another feedstock. If it was more competitive, it would have already been done. But the reality is there are pressures out there and there are demands to go to a circular economy and there seems to be a growing consumer base that's willing to pay for that. Now we just have to work out what the value chain looks like.

The second thing on the consumer side is we have a waste problem which none of us have our heads in the sand about. We have a plastic waste issue that needs to be resolved. And in order to drive that circular economy, we've got to come up with a way to value the plastic waste so that it can come back into that feedstock supply. And that's probably the bigger challenge. I think we will come up with a way to do it. I think everybody in the value chain that's part of the alliance that we've put together is trying to figure that out. But that's going to require some time and some things for us to work through.

Meanwhile, the size of these projects that I'm talking about are going to help us learn more about what the cost positions are, are going to help us learn more about what the customer acceptance is going to be for these products and what the price point for that will be. And I think in another year or so, I'd have a better answer for you on what the relative values are.

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

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

**Operator**

And once again, that does conclude today's conference. We thank everyone for their participation.



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