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PRESENTATION

Operator

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

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

Good morning, everyone. Thank you for joining us to discuss the fourth 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 in the Dow earnings release, in the slides that supplement our comments today and on the Dow website.

On Slide 2, you'll see our agenda for the call. Jim will start with an overview of Dow's fourth quarter and operating segment performance as well as an update on Sadara. Howard will then move into a financial overview of the quarter, including details on our principal joint ventures and will also provide some comments on modeling guidance for the first quarter and full year. And finally, Jim will provide a review of Dow's performance against our 2019 targets and then close with our priorities for 2020. Following that, we will take your questions.

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

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

Thanks, Neal, and thanks, everyone, for joining us this morning. Starting on Slide 3. The Dow team once again executed against our operational and financial playbook to close a pivotal year in the company's history. We captured growth, achieved another year-over-year improvement in cash from operations and delivered leading returns to shareholders.

Our results showcased the resilience of our portfolio and our ability to leverage our core strength and our focus on delivering value to our customers and owners. Here are some notable highlights from the quarter.

First, we continued to capture demand in key end markets, particularly those closer to the consumer. The trends in the fourth quarter mirrored what we've seen all year: Solid demand in consumer-driven staples, offset by lagging or contracting demand in industrial segments and in applications related to big ticket items such as automobiles. Overall, excluding the Hydrocarbons & Energy business, we achieved volume growth of 2% in the quarter.

Second, we continued to drive a lean cost structure. We removed more than $35 million of stranded costs in the quarter.

And third, we remained focused on generating strong cash flow and utilizing our free cash flow in a balanced way, aligned with our capital allocation priorities.

We generated $1.9 billion of cash flow from operations, up more than $500 million year-over-year. Our EBITDA to cash from operations conversion rose significantly to 110%, supported by the inflow of cash from the legal judgment with Nova as well as the release of cash from working capital. These factors enabled us to execute more than $1 billion in deleveraging as well as return $600 million to our shareholders.

I'm proud of the Dow team's performance in the face of challenging industrial market and trade dynamics. Once again, we demonstrated our ability to control the things that we can control while pursuing growth opportunities in our targeted end market. And equally importantly, these results represent solid progress against the priorities we laid out a year ago, which I will review later in the call.

Moving on to our segment results in the quarter. On Slide 4, Packaging & Specialty Plastics operating EBIT was $648 million. The benefits of stranded cost savings and volume gains in the Packaging & Specialty Plastics business were more than offset by lower polyethylene prices and reduced equity earnings.

The Packaging & Specialty Plastics business delivered 4% volume growth, led by double-digit growth in Asia Pacific. We continued to see solid demand growth in our key packaging end market, including flexible food and specialty packaging, industrial and consumer packaging, and health and hygiene applications.

Hydrocarbons & Energy reported both lower volume and price. Volume declines were primarily due to planned turnaround activity in Europe, which led to reduced hydrocarbon co-product sales.

On Slide 5, Industrial Intermediates & Infrastructure operating EBIT was $221 million, primarily reflecting margin compression in polyurethane component as well as lower equity earnings largely driven by margin compression in MEG at the Kuwait joint ventures and in glycol ethers at Sadara. Industrial Solutions reported lower net sales, primarily driven by lower prices for chemical intermediate. Volumes also declined modestly, primarily in ethylene glycols, which was partly offset by growth in heat transfer fluids and pharmaceutical applications.

The Polyurethanes & Construction Chemicals business reported modest volume growth driven by gains in construction chemicals applications, and this was more than offset by local price declines for polyurethane intermediates.

And finally, on Slide 6, Performance Materials & Coatings operating EBIT was $233 million. EBIT rose year-over-year, in part due to lower cost in the Coatings & Performance Monomers business, which was impacted by an extended turnaround in the fourth quarter of 2018.

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Sales declined as a result of weaker local prices in all regions, primarily due to lower siloxanes prices. Consumer Solutions delivered flat volume versus the year-ago period. Growth in high-performance infrastructure applications globally as well as improved demand for siloxanes in Asia Pacific and the U.S. and Canada was offset by demand contraction in automotive and consumer electronics end markets.

Coatings & Performance Monomers sales declined due to lower local prices and volumes. On a regional basis, coatings volume was primarily impacted by lower demand in the U.S. and Canada and Europe.

Before I turn it over to Howard, I want to give an update on our progress at Sadara. As we mentioned last year, we had one remaining logistics service agreement to get signed by parties in the Kingdom in order to start the process of achieving project completion. I'm pleased to report that the parties have reached agreement in principle and the official signing is imminent. And as a result, the remaining steps to achieve project completion are underway.

As we've discussed before, achieving project completion is an important milestone for several reasons. First, it formalizes Sadara as a fully operational venture. Second, it enables the parent guarantees that Dow has on Sadara's debt to be released. And third, Sadara will then move forward to reprofile its debt. The debt reprofiling is a critical next step for Sadara in providing the JV with enhanced financial flexibility.

The JV expects these discussions to take place over the course of this year, and we will provide another update once they have more to share. Sadara offers an impressive suite of world-class assets, technologies and products. Both Dow and Saudi Aramco remain aligned as shareholders in getting Sadara to a self-sustaining financial position as soon as possible.

Finally, as you look through our fourth quarter results, you will see that we recorded a write-down of our equity investment in Sadara. I want to emphasize that this action does not detract from our belief in the JV's ability to enhance its financial strength and achieve independence. Rather, it is a reflection of our view of the latest financial projections for the JV relative to the book value of our investment.

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

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

Thanks, Jim, and good morning, everyone. Turning to Slide 8. Net sales were $10.2 billion at the high end of our guidance range. Local price declined 12% year-over-year, driven primarily by declines in polyethylene, isocyanates and hydrocarbon co-products. Currency decreased sales by 1%.

Volume declined 2% year-over-year, largely driven by lower hydrocarbon co-product sales. Excluding the Hydrocarbons & Energy business, volume was up 2%, led by demand growth in packaging and construction chemical applications. Equity losses were $21 million.

Operating EBIT was $1 billion. Tailwinds during the quarter included savings from stranded cost removal, contributions from new capacity on the U.S. Gulf Coast and improved earnings in the Performance Materials & Coatings segment. These gains were more than offset by year-over-year margin compression in our core value chain, lower equity earnings and higher planned turnaround costs.

Operating EBITDA margin improved by 33 basis points year-over-year. And excluding equity earnings, it expanded 75 basis points. Our fourth quarter operating EBIT results also benefited by approximately $50 million from a few discrete project-related items. These included 2 items in our Industrial Solutions business, catalyst sales and a large concentrated solar power project.

Below the EBIT line, we reported an unfavorable tax rate year-over-year and versus our guidance, resulting from a change in our mix of geographic earnings. Notably, we experienced a drop in earnings in Europe due in part to a reduction in integrated polyethylene margins as well as turnaround costs related to the planned maintenance outage at our cracker in the Netherlands. This was offset by favorable interest expense, D&A and share count.

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Operating EPS was $0.78. On a GAAP basis, we reported a loss per share due to significant items that totaled $3.92 per share. This was driven by several items in the quarter. We recorded a noncash impairment charge of $2.85 billion, which included a $1.75 billion write-down related to Sadara that Jim mentioned, as well as a $1 billion impairment of goodwill associated with the Coatings & Performance Monomers reporting unit. These write-downs were conducted following our annual financial projection reviews, which determined that the carrying values were higher than the fair values.

Moving to cash flow. As we laid out at our Investor Day in 2018, we've been applying a much greater focus on enhancing cash flow. And once again, the Dow team delivered a strong quarter on our cash metrics.

We generated $1.9 billion of cash from continuing operations, which was driven by improvements in earnings-to-cash conversion supported by a more than $400 million release of cash from net working capital.

Finally, we allocated our free cash flow in a balanced way, in line with our capital allocation priorities. We paid down more than $1 billion of debt in the quarter and returned $611 million to our owners, including the remaining $100 million of share repurchases left to achieve our $500 million share repurchase target for 2019.

Turning to our principal joint ventures on Slide 9. Equity losses for the quarter were $21 million. This was primarily driven by lower results at our Kuwait joint ventures as a result of margin compression in MEG and polyethylene as well as reduced cracker and polyethylene margins at our Thailand JVs.

Sadara reported a modest improvement in earnings as the benefits of volume gains and cost control more than offset price declines.

Moving to Slide 10. We continue to provide modeling guidance on a sequential basis as we believe this is the most relevant way to explain the dynamics, given the current market conditions. We see first quarter being stable with where we ended the fourth quarter. As I mentioned before, we had some project-based items in the fourth quarter that benefited our results. After adjusting for those items, the key drivers are tailwinds from lower turnaround costs and normal seasonal recovery from the fourth quarter, headwinds from an ongoing third-party supplier outage near our Tarragona, Spain site; lower results in our JVs, primarily due to compressed spreads in Asia; and a nonoperational headwind from higher pension expense as a result of lower discount rates at the end of 2019.

In Packaging & Specialty Plastics segment, we entered the year expecting overall stabilization with some regional recovery. With negative integrated polyethylene margins in Asia and European margins low as well, we expect price increases to gain traction from the low point at the end of 2019. If they don't, we expect high cost producers to come under pressure. And in fact, we've already seen some competitors trim back rates in the fourth quarter for that very reason.

The Industrial Intermediates & Infrastructure segment will benefit from the lower turnaround costs compared to the prior quarter. However, as I mentioned, we're currently impacted by a third-party supplier outage near our Tarragona, Spain site, which has forced us to take some EO derivative capacity offline.

And finally, in Performance Materials & Coatings, we expect siloxanes pricing to remain relatively flat with the fourth quarter. In Coatings & Performance Monomers, we expect a normal seasonal uplift in profitability. The core business performance, however, will be offset by higher planned turnaround activity at our performance monomer site in Texas.

Turning to full year 2020 on Slide 11. There are several items for consideration as you update your models. We've provided the income statement and cash flow items that we can forecast at this time. We expect our 2020 JV equity earnings to be lower than 2019, largely due to the averaging impact as key spreads did not bottom until the second quarter of 2019.

We also anticipate planned turnaround spending to be flat year-over-year. And as I mentioned before, we expect higher pension expense of $125 million year-over-year, and we provided the estimated split of that headwind by segment.

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Below the EBIT line, we once again anticipate lower interest expense as a result of our lower debt level. We see our tax rate range moving higher this year as we're forecasting a change in our geographic mix of earnings, particularly due to lower earnings in Europe. And finally, our share count estimate includes base case share repurchases to offset dilution.

Some selected guidance for cash items is included on the right and on the next slide, we have provided a review of our known cash upsides and downsides to give some context for our free cash flow optionality this year. So with that, let's turn to Slide 12.

There is no change in our cash priorities for 2020. We remain focused on generating solid cash flow from operations and improving our cash flow conversion, and we will continue to prioritize our use of free cash flow between deleveraging, incremental CapEx targeting lower-risk growth opportunities and returns to shareholders.

Our base case operating cash flow upsides and downsides are shown here. Cash upsides include reduced integration, separation and restructuring spending, slightly lower required cash contributions to our pension plans, interest expense savings and an inflow of cash from a fence-line customer for an ethylene capacity reservation fee, which we expect at the end of 2020.

Regarding CapEx, we see our spending in a range of $1.5 billion to $1.75 billion this year, which gives us an additional $250 million to $500 million of flexibility to either apply toward our free cash flow priorities or pursue incremental growth investments. And given that there is still work ahead for Sadara, we're conservatively assuming that our contributions will remain flat with 2019.

Downsides include a decrease in JV dividends as the JVs pay their dividends based on the previous year's earnings. Our base case does not assume any nonoperational cash inflows related to our remaining legal proceedings with Nova and therefore, we show a year-over-year decline.

With that said, we continue to actively pursue resolutions in our favor on 2 items, reclaiming the tax withheld on last year's pre-2012 judgment and obtaining a judgment on the post-2012 case.

The most important takeaway here is that we expect our cash generation in 2020 to leave us with free cash flow optionality. We have a few key priorities that will dictate how we deploy this cash. The dividend remains our #1 priority. We are currently on the high side of our capital structure targets, and so deleveraging continues to also be a key priority as well as putting more investments into our businesses where we see lower-risk, quicker payback opportunities.

Should market conditions show improvement, we could also lean more toward returning additional capital to shareholders. Further cash optionality could also come from nonoperational items. The items listed on this slide hold additional free cash flow potential of approximately $1 billion. All of these items are in motion, and we will continue to provide updates on them as we make progress.

In sum, we're confident about our ability to deliver against our disciplined financial playback (sic) [playbook] this year, and we will continue to deploy free cash flow in a responsible manner that balances our actions to improve our debt profile, strengthen our financial flexibility and reward our owners.

With that, I'll turn it back to Jim.

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

Thanks, Howard. Turning to Slide 13. Just over a year ago, we laid out to investors a clear set of near-term priorities for Dow that reflected our more focused, disciplined and market-oriented company. And in 2019, we delivered on these priorities.

We controlled the factors in our control and we showcased our resilience. I'll spend the next few minutes highlighting the key progress we made in 2019 against our objectives, starting with Slide 14.

Our focus on profitable growth helped us navigate the headwinds that we faced throughout 2019. Our U.S. Gulf Coast investments enabled top line volume growth in the Packaging & Specialty Plastics segment as well as bottom line contribution, thanks to the U.S.

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Gulf Coast's global cost competitiveness.

Even in the midst of a year of market challenges, our packaging business grew volume year-over-year every quarter in 2019, which ultimately reflects our business' global competitiveness.

Our silicones franchise completed 16 incremental growth projects, unlocking additional downstream capabilities and driving higher captive siloxanes consumption. This will continue to be our focus going forward as downstream silicones applications can deliver up to 1,000 basis points of margin uplift over commodity siloxane. We reached final investment decision on our flexible alkoxylation capacity expansion and signed a 10-year supply agreement with a key customer, and we announced plans to retrofit an ethylene facility in Louisiana with our new proprietary fluidized catalytic dehydrogenation technology to produce on-purpose propylene.

Our digitalization efforts helped us improve our customers' experience. In 2019, we launched an expanded e-commerce portal on dow.com. We achieved nearly $3 billion of revenue on the portal in 2019, and we have plans to continue growing sales through this channel.

Turning to Slide 15. We demonstrated a balanced and disciplined approach to capital allocation. First and foremost, we redoubled our focus on cash and improved our cash flow conversion to 78%, which was 37 percentage points above the conversion rate we had in 2018.

In the fourth quarter alone, we achieved a conversion rate of 110%, as we benefited from a combination of operational and nonoperational cash improvement. We also prudently managed capital spending, responding to the softer market conditions by proactively cutting CapEx spending to $2 billion or $500 million below the target set at the beginning of the year.

More importantly, we tilted our growth cap toward the highest return businesses, pushing forward our wave 2 investments in our packaging, silicones and industrial solutions businesses. These actions enabled us to deliver $3.8 billion of free cash flow in 2019, which we deployed to drive toward our capital structure targets and to reward our shareholders.

We strengthened our debt maturity profile by paying down more than $3 billion of debt, and we conducted opportunistic liability management such that our next material debt maturity is not until the second half of 2022. We did all this while also delivering $2.6 billion to our shareholders through our strong dividend and share repurchases.

Turning to Slide 16. We continue to reduce our cost structure. We achieved more than $600 million in cost synergy and stranded cost savings in 2019. This included more than $160 million of stranded cost removal and the completion of a $1.365 billion cost synergy program.

As a result of streamlining and optimizing our organizational and management structure over the past few years, we closed 2019 at the headcount that we targeted at our Investor Day a little more than a year ago. These actions were also shaped by our enhanced focus on benchmarking, which brings me to our final pillar, best owner mindset on Slide 17.

We followed through on our commitments to increase transparency and disclosure. We moved to ethylene market-based transfer pricing, shifted our primary profit metric from EBITDA to EBIT and disclosed our key product capacities. We enhanced our focus on benchmarking to develop a clear picture of our competitive position in the market and share that output with shareholders on a periodic basis. These were critical steps to drive towards best-in-class performance.

On the portfolio management front, we completed a number of incremental transactions aligned with actions to clean up and simplify our footprint. During the fourth quarter alone, we shut down a polyurethanes facility in Australia as well as a coatings manufacturing facility in the U.S. We transferred ownership of a coatings emulsion plant in Germany to Trinseo. We sold our acetone derivatives business and associated assets, site infrastructure, land and utilities in West Virginia to ALTIVIA; and finally, we sold our La Porte, Texas site.

In summary, we did what we said we would do. And the framework we used in 2019 applies once again to our priorities in 2020, which

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we outlined on Slide 18. In terms of growth, even though we plan to keep our capital spending restrained, we will still progress our suite of higher-return, lower risk growth investments.

On the immediate horizon, we expect the 2 new furnaces at our Texas-9 cracker to come online by the middle of second quarter 2020, with commissioning projected to start toward the end of first quarter. This will bring the cracker's capacity to 2 million metric tons, making it the world's largest ethylene facility.

And today, we're announcing plans to incrementally expand capacity at our ethylene facility in Western Canada by approximately 130,000 metric tons with the addition of another furnace. Dow will co-invest in the expansion with a regional customer, evenly sharing the project costs and ethylene output. This expansion leverages our unique cost-advantaged feedstock position in Western Canada.

The additional ethylene will be consumed by existing polyethylene assets in the region, making the investment immediately accretive once it comes online in the first half of 2021. Dow will fund this project within our stated CapEx spending targets.

We also have more incremental silicones investments on deck in 2020 as we're targeting another 12 debottlenecks this year. We expect to complete stranded cost removal by capturing the remaining $140 million of savings, and we'll also focus on continuous productivity, not only in terms of cost, but also manufacturing efficiencies. As Howard mentioned earlier, we have plenty of operational and nonoperational cash flow actions that we are pursuing.

Finally, we will continue to apply a best owner mindset to all we do. The Dow team continues to evaluate additional incremental footprint cleanup options, much like the ones we completed in the fourth quarter of 2019. We will provide updates through the year as we have information to share.

Before I wrap up my comments, I will provide our current outlook, which is on Slide 19. Many of our key product lines were challenged throughout 2019. However, our advantaged positions on the cost curve, global diversification and differentiated products have allowed us to continue capturing volume growth around the globe.

So far in 2020, we have seen similar conditions to those at the end of 2019, but the dynamic is now beginning to shift. As macro conditions weakened into the end of 2019, third-party industry reports indicated that high-cost producers in many chains were struggling with breakeven or negative cash margins.

For example, in polyethylene, capacity in Europe and Asia that utilizes naphtha feedstock, which represents a significant amount of global capacity, was at 0 or negative margins for much of the fourth quarter. MDI spreads around the world have continued to bounce around what we believe are breakeven levels and siloxane prices in China have also hovered at breakeven levels for at least the last 6 months. For these reasons, third-party industry reports have suggested that producers with fourth quartile cost position are considering or implementing rate cuts or extending planned turnaround. And in the past few months, we have seen public announcements by some producers delaying new capacity additions.

And with inventory levels normalizing in some of our chains, we see a good environment for an inflection to gain traction. In our view, it is still too early to claim sustainable improvement. And in fact, it could take some time for the dynamics to play out. But that said, we are seeing early signs that support gradual improvement in the near-term from the lows that we reached at the end of 2019.

So to close on Slide 20. As we enter 2020, we are taking a conservative view given the macro and micro trends that we are seeing. Recent trade resolutions should be a positive for sentiment, but it may take some time before we see this translate into improved fundamentals.

Even after the Phase 1 U.S.-China agreement, a majority of the original tariffs are still in place, which will continue to weigh on supply chain as well as consumer and investor sentiment. As such, the same discipline that we showed in 2019 will guide our actions in 2020.

We're not counting on end market conditions to determine our success. Rather, we have a suite of actions and advantages within our

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control. We will continue to be financially disciplined. Our portfolio will remain competitive, thanks to our operational and footprint advantages. We will continue to generate strong free cash flow and responsibly allocate that capital along the lines of our priorities, and we will continue to institute self-help measures.

These factors will serve us well as our end markets stabilize and reset. And just as important, they put us in the best position to continue serving our customers and rewarding our shareholders.

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

QUESTIONS AND ANSWERS

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.

Operator

(Operator Instructions) And our first question we'll hear from Arun Viswanathan from RBC Capital Markets.

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

I'm just curious, it sounds like basically, you're seeing a potentially supply-driven inflection point, there is maybe some rate cuts by competitors on the motivation of weak margins. I guess I'm just worried that if demand does improve and we see some slight improvement, industrially speaking, would that prevent some of these supply shutdowns going forward and kind of crimp off the recovery that you're potentially seeing? Maybe you can just offer some thoughts on how that materializes over the next couple of quarters.

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

Arun, this is Jim. Thanks for the question. I think what we saw and what we've seen out of the third-party reports is that you had some fairly significant deltas on cash margins for some of the -- especially naphtha producers in Asia and a little bit in Europe, too.

In fact, we got to a couple of periods in the last several weeks where it was negative to as much as $0.10 to $0.12. So that's a lot to absorb if you're at the bottom of the cycle. So I'm not sure that we would see it all come back on, but you can always bump around here a little bit.

I would also point back to -- we had very strong demand in plastics. So plastics was up 4% in the quarter. 4 consecutive quarters of volume growth in plastics. So I think demand is out there, and I think our cost positions are good. And that's really what's helped us out.

All the investments we made over the last 5 to 7 years really brought us down on the cost position, feedstock flexibility as well as just the lower cost of the crackers, and that's what's going to help us navigate through here.

Operator

And next, we'll move to Hassan Ahmed with Alembic Global.

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

A 2-part question on China. First, obviously, relatively new news about this plastic ban. How should we be thinking about that? And again, early days, but what are your thoughts about the demand impact from the coronavirus?

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

Thanks, Hassan, for the question. First, on the plastics ban. From a Dow perspective, we don't produce materials that go into most of those products that were banned. So straws and lightweight ag films and some of the T-shirt bags is not a market for us. Most of what we're selling into China goes into more durable packaging, goes into flexible food packaging, and that demand continues to be strong.

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Health and hygiene markets, obviously, continue to be strong. Nonwovens is a big market for us as well.

On the coronavirus. I had the experience to live there during the SARS epidemic, and it feels like to me, what we went through during the SARS time period, you're seeing an impact on tourism. People staying at home, people not going to restaurants. The service industry gets hit a little bit. People may be making a run at the grocery store to stock up on things. You're seeing some pull on demand on things like materials that are going into household cleaners or disinfectants, nonwovens that are going into masks or wipes. So we're seeing some of that pull on demand. And I know our counterparts at DuPont are also seeing that, for example, on pull on some of their nonwovens and their surgical masks and things as well.

It'll take -- once we figure out how to treat this, things will start to return to normal. And I think it took us, in SARS, a few weeks to really -- WHO and CDC to figure out how to treat it, and then everybody started to kind of get back into normal life.

Customers have not gone back from Chinese New Year yet. So I talked to the businesses yesterday, they're still seeing customers take an extended Chinese New Year. But I would imagine in another week, they're going to have to go back because demand for some of their products is starting to pick up, too.

Operator

And next, we'll move on to Vincent Andrews with Morgan Stanley.

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

Just to come back to the Asian margins on polyethylene. One of the things that we've noticed is that a lot of the negative margin has come from the increase in the naphtha feedstock cost rather than a decrease in the price. Although, I guess, it's been slightly weak. So oil prices have been flat. So can you give us an assessment of what's going on in the naphtha market? And what would happen if naphtha prices retreat, but PE prices, therefore, don't improve in terms of the sort of expectation for a recovery in the first half?

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

Thanks, Vince. That's a good question. And I do agree with you that, that naphtha movement up and down is a big contributor to what we saw happen with those margins, both in Europe and in Asia Pacific, the Asian pricing has been stable. So that's been a good thing, even at the end of the year.

And typically, at the end of the year, you would see people doing some destocking. You might expect that product to get depressed, but it held up pretty well. But I think it's holding up well because the breakeven costs over there are much, much higher.

So if we're running at the bottoms right now on Asia and on Western Europe, and we've still got this advantage on Canada, Argentina, U.S. Gulf Coast. I think it speaks to the fact that the high-cost producers are going to be under pressure for a while. And I think that's why the third-party reports are out there saying people are pushing out expansion. People are talking about shuttering in some capacity. We'll see how that develops.

The other thing I would mention is that, typically, in March to June, that's the heavy turnaround season for ethylene. And usually, historically, you have about 8% of the capacity offline. A lot of the third-party reports that are out there right now on turnaround activity have as much as 15% of that capacity offline. So I think as we go through the quarter and some of that capacity comes off, we're going to see some opportunity there for some pricing and some margin expansion.

Operator

And next, we'll hear from Jeff Zekauskas with JPMorgan.

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

What was the -- is the $500 million that you plan to put into Sadara optional on your part? Or was it part of a contractual obligation? What's the theory behind the additional investment? And are there any obligations that you'll face in 2021? Or is this the end of the investment?

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

Jeff, this is Howard. That $500 million is what we had to put in last year. As you look at Sadara, where we are in the cycle with chain margins and polyolefins and isocyanates, they've got enough cash flow that they're generating to cover their own costs and to cover their interest expense. But the project was project financed, and that project financing all is -- now that the project is fully operational, the principle is coming due, and they don't have enough cash to generate to pay all of that principle. So that $500 million is roughly our expectation that 2020 conservatively will look like 2019. And in 2019, we had to put in $500 million, which was our 35% ownership of the principle.

And so what we talked about, what Jim talked about on the, I think, in the prepared remarks, is that we've got agreement in principle now on the logistics agreement to -- that's the last remaining step, signature of that document is imminent. At that point, we will have achieved project completion. And then we -- Sadara will work, with the support obviously of both Dow and Aramco, to reprofile the debt with the lender group. And so that's our focus. And that -- our expectation is that'll take us through the better part of this year to get that done.

So conservatively, for modeling purposes, we said, look, we'll put the $500 million in there just to -- as a precaution.

Operator

And moving on, David Begleiter with Deutsche Bank will have our next question.

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

Jim, just looking back on Q4, just a 2-part question. First, PM&C. Can you just comment on how it was so strong given some weak siloxane margins? And second, the $50 million of catalyst sales and other benefits, solar fill benefits, were those expected to be realized in the quarter when we last spoke back in October, November?

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

Yes. So thanks, David. Good question. One of the main things we had was we had lower cost this fourth quarter than last year because there was a turnaround fourth quarter of '19 -- or of '18, and we didn't have that in the fourth quarter of '19.

We also saw lower propylene raw material costs. So we had PDH out in turnaround and propylene prices actually came down pretty significantly. So that rolled through on the acrylics chain. So you see some of that impact. We did get some margin expansion. So we saw siloxanes pricing slightly improve, and we also saw some volume gain in siloxanes versus what we had expected.

And to your point on the 2 onetime things, catalyst and the solar fill. We had expected those to come. You never know exactly when the timing of those is going to happen because they're capital projects. So when the solar fill charge comes when they tell you, hey, deliver the material, we're ready to load up the plant, and that just happened in the fourth quarter. So I think that one, you can look at and say that one wasn't expected in Q4.

Operator

And we'll move on to Jonas Oxgaard with Bernstein.

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

I was wondering if we could talk a little bit about your capital policy for 2020. As far as I can tell, there's no buybacks in the guidance. But it does look like you should have some CapEx -- or some cash left over. Am I missing something here?

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

Let me talk a little bit, Jonas, about how we're approaching CapEx and then I'll get Howard to talk about cash priorities for the year.

So we're going to start the year here with a target of $1.75 billion of Capex. We'll keep all of our incremental high-return debottlenecks in place. Talked about the furnace add in Canada, that's on the capital list. The 2 furnaces that are going on to Texas-9 will go into commissioning in March. So that's on -- finishing up, that is on the capital list. About a dozen debottlenecks in siloxanes and the

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alkoxylation facility that we're putting in place to support that 10-year contract.

Additionally, we're making the investment to retrofit FCDh into one of the Louisiana crackers, and that is really to be able to deliver propane-to-propylene economics at a much lower scale than PDH, but also do it with like 20% less greenhouse gas emissions, 20% less energy cost.

So we're going to be able to really do PDH scale economics that we did over PDH 1 at 150,000 to 200,000 tons. That's a big breakthrough for us. And then that becomes a great licensing opportunity for us.

Now we paid down $3 billion of debt in the year. But we wanted to pay down a little bit more than that. So when we look at remaining capital, we have to keep it balanced between deleveraging and what we all want to do for share buybacks. And what's in the base case here is we will cover dilution. I think you'll see from our share count that we've been doing a good job of making sure that shareholders don't get diluted. So that's first priority.

Howard, do you want to talk about the other priorities?

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

Yes. Thanks, Jim. Jonas, I mean I think Jim covered it well. Our target that we laid out at Investor Day is to cover dilution every year at a minimum. So when we look at the margin compression that we had last year, and we look at the capital -- we look at our capital structure targets over the economic cycle, we're on the higher end of that range. We did a very good job of doing $3 billion, as Jim said, of debt paydown last year, but we want to do a little bit more.

So as we enter 2020, the primary focus after the dividend and after the $1.75 billion of CapEx is really to incrementally continue to delever with operational cash flows. With that said, Jonas, and I think your point is very valid, and you look at the slide that we put out in the deck, we are a cash-generating machine. And so as we continue to drive higher cash flows. You can expect a balanced approach with additional debt paydown and additional shareholder remuneration. But we just felt like it was prudent, given the capital structure targets, to start the year with a preferred focus on debt paydown.

Operator

And we'll move on to Frank Mitsch with Fermium Research.

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

I want to come back to the Polyurethanes & Construction Chemicals business. You reported some positive trends on the construction chemical side. I was wondering how sustainable that was. And then again, on Slide 19, in terms of polyurethanes, you're showing MDI as having -- the MDI spread as having bottomed in September, and so I'm wondering if you could talk about what your outlook is there. Are we going to flatten out? Or is this a sustainable sort of recovery there? Any sort of color there would be very helpful.

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

Frank, I think on the MDI spreads, I think the current levels that we're at are probably sustainable. You could see some pressure down on some of that. But I'm hopeful with the U.S.-China deal done that, that gets some confidence back in the markets and some of those downstream derivatives start to pull demand and that'll firm things up a little bit.

As it comes to construction chemicals, we've seen good volume and good demand in the housing side. And I think it's held up better for longer than we had expected. It's going into a wide number of applications, which has been good. And it's offset some softness that we've seen in some other parts of the PU business, for example, systems into automotive and into furniture and bedding. You don't think of it, but sometimes a mattress is a high-ticket item. But they were under some pressure because of the price of a mattress, it's one of the things that consumers, if they're tightening the belt a little bit, will kind of slow down purchases on. But no, construction looks good, and I think we're off to, with the weather, we're off to a pretty reasonable start to the year.

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Operator

And next up, we'll have Steve Byrne with Bank of America.

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

I wanted to ask you a little bit about your best owner mindset. What's your long-term view of the value proposition of your key joint ventures? And is your ownership of those the best use for Dow? And then also related to this best owner mindset. I was curious as to whether your recent benchmarking analyses has identified any new opportunities for you for a headcount reduction. You mentioned the e-commerce platform is gaining traction. Is that an area where you think that might ultimately lead to trimming the sales force?

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

Yes. Thanks, Steve, for the question. On joint ventures, we do joint ventures for several reasons. The 3 key joint ventures that we have today, we have strong partners with, and they were for the reason of market access and to make sure that we had access to low-cost feedstocks.

So when you look at that, you have to think about it in context of how do I serve the market with my customers if I don't have access to that partnership and that feedstock? Our priority on the ventures is we want them to be self-sustaining and self-funding and stand alone. That's why we're doing what we're doing with Sadara.

The Kuwait joint venture is already in that spot. The Thai joint venture is also in that spot. And then they can -- as they improve, they can yield dividends and pay back or they have the ability to fund their own growth as they move forward.

All of our partners in the JVs are committed to that mindset, have the same mindset as we do. And obviously, what we need to do with Sadara is get through this debt reprofiling to get it in the best long-term sustainable solution. We're doing a lot of work on footprint. Most of that would be, think of divestiture work, like what we did in the fourth quarter, exiting a facility in a market that has declined, like Australia in polyurethanes was not competitive. Looking at our La Porte, Texas site, moving that capacity over to Freeport, getting off of that site, selling that site to somebody who really wants to come in and expand there. It's a good site. It's a good location. We only have one asset on that location. So we needed to make a change there.

And then, obviously, we will look at product chains that inside Dow may not get investment money like we did with acetone derivatives in West Virginia. That's -- there's a better owner for that business. And we're continuing to look at that. On digital, I believe digital is going to help us in 2 ways. If I look at the silicones business, Consumer Solutions, they are one of the most [sard] efficient businesses that we have. They're doing about $3 billion of sales through that digital portal. What they do then is they focus their sard capabilities on application development and very close customer contact. So they pull through a lot of demand through that chain.

But what digital really does for us is help us get that end customer and that end-to-end signal back into our plants. So in polyurethanes, to give you an example, as we are able to get good demand signals, and that's a very complicated integrated chain through that polyurethanes chain, we can run the assets differently. In some cases, we can free up as much as 10% to 20% of incremental capacity off of an asset. So it isn't just about sard. It's also about how we run the asset, how we get working capital out.

We did $400 million of working capital out in fourth quarter by the old-fashioned way. When we get digital rolling, I think we're going to have the capability to see more working capital improvements.

Operator

Next, we'll hear from John Roberts with UBS.

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

Congrats on an upside quarter. When you reprofile the Sadara debt, do you get paid back on these $500 million contributions right away? Or does that somehow get rolled into your investment in your equity?

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

Yes, John. Hey, I don't want to have that negotiation with the lenders on this earnings call. What I would say, though, is I wouldn't expect that. I mean because that's been a historical principle. I really think our focus is really trying to get -- to use Jim's words, to try and get Sadara to a cash flow self-sufficiency.

So looking to the lenders and working with them to extend the tenors and/or to adjust the amortization tables, not to take a haircut. And that's our primary focus of what we're going to be working with them on.

Operator

And Christopher Parkinson with Crédit Suisse will have our next question.

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

Just a corollary to the question before. Can you just comment on your -- any updates on your intermediate-term outlook for the MDI [SD], just break out some key variables in the context of some capacity delays and so on and so forth. Just any update on your longer-term spread expectations.

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

Yes. MDI, I think MDI's exposure in the marketplace, Chris, is basically in those areas that I talked about that have been a little bit slow, automotive; some of the more rigid polyols and so appliances, those things pull on the MDI chain. That's been what's been the softest. There have been announced delays in capacity expansion, which makes obviously a lot of sense given where we are in the market and the spreads. And there's enough capacity out there to satisfy the demand for a while.

So I think you'll see these are not easy facilities to build and they're not easy facilities to operate. My sense is now that we've got a little bit of confidence coming back in after the trade deals and we start to see maybe some people seeing their way through higher demand if automobiles start to pick back up, you're going to see things tighten a little bit and these spreads have the potential to go up.

Operator

And next up, we'll hear from P.J. Juvekar with Citi.

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

Yes, a question on recycling. It seems that specialty and engineering plastics continue to grow while the commodity plastics come under pressure, your bags, your straws. How much of Dow's portfolio is in specialty category? And is there an update on recycling initiatives from the Alliance? And is it mostly focusing on recycling -- mechanical recycling? And do you have any long-term view on polyethylene demand growth?

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

Yes, good question, P.J. So I'd say our portfolio today is probably running around 40% of the higher-value materials. So all of our functional polymers business would be in that category. That's about 25% of what we sell out of P&SP today. And then another 15% on the high end of P&SP would be in things like health and hygiene products, et cetera, which are probably not in that same space.

Recycling and these bands have been targeted at low-end single-use, I would say, commodity types of materials. And people just aren't getting their heads around the need for behavioral change at the consumer level to make that happen. So what we're working on with the Alliance, we now have more than 46 members in the Alliance, and it's growing every day. We're focusing on chemical recycling back to feedstock so that we can make recycled plastic out of taking the plastic, going back through chemical recycling and back through the cracker and the plastics plant.

We're looking at mechanical recycling and going into high-volume applications like construction materials, pallets, crates into asphalt for roadways, any number of those applications, they're going to be waste-to-energy facilities.

There's a large facility right now in Indonesia, 500,000 tons, mixed-use recycling, waste-to-energy, chemical and mechanically recycling

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both. We have several projects like that with the Alliance. We have a project with Nobel Prize laureate, Muhammad Yunus, working on a Zero Plastic Waste City in India, showcasing what can be done there. You're seeing, across the board, tremendous amounts of recycling activity. One of our customers, Sealed Air, just announced that they've taken bubble wrap to post-consumer recycle. We launched AGILITY CE last year, which is up to 70% post-consumer recycled material. You're going to see that go into things like collation shrink for water bottles or beverage cases. And we're getting it into a whole host of other applications.

So this has taken off in a big way. Big announcements, like Nestlé saying they're going to spend $2 billion to buy post-consumer recycled packaging, are great because we need that demand pull on the chain to make this work.

Operator

And next up, we'll hear from Bob Koort with Goldman Sachs.

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

This is Dylan Campbell on for Bob. Quick question on your U.S. cracker fleet. We saw propane prices come up in the fourth quarter. So I'm curious on kind of your ability to flex your U.S. cracker fleet in the fourth quarter relative to the third quarter. And then in early January, I think -- or thus far in January, propane prices have come back in. So I guess kind of what your ability is to flex in the first quarter relative to the fourth quarter.

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

Yes. Good question, Dylan. We have the ability to flex -- we can flex every day, but that doesn't sometimes make sense. But every week, we're looking at the flex that we need to take.

Ethane has been in rejection here recently. So it's been advantaged. But there were periods in the fourth quarter where our variable costs from cracking propane were extremely low and butane has been in the mix all year as well. I'd say, with what's going on with TPC and the C4s, we're watching butane because we create a lot more C4s out of that, and so we don't want to get ourselves into a jam on C4s.

But propane has been advantaged. Propane advantage is a big advantage for Dow because we have more flex in the industry. We can crack up to 70-plus percent propane in the fleet in the U.S. Gulf Coast. And it's been an advantage for Europe as well. So we've been able to crack LPGs all through the fourth quarter, and we're cracking now in Europe.

Operator

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

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

With regard to the silicone's debottlenecking, the new furnaces at Texas-9. Can you kind of ballpark the opportunities in terms of the earnings add that, that can give you this year? And then also, do you have any incremental cost-cutting or efficiency levers that you can pull just given the difficult backdrop? I know you have a little bit of the -- still working on cutting out some of the costs tied to stranded costs from the separation, but anything beyond that, that we should be thinking about?

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

Yes. John, we've got another $140 million of stranded costs to come out this year, and we're well on track to deliver that number. And we're obviously looking to liberate more out of working capital, as I talked about and get that cash and some nonoperational things like the remaining settlement of the 2013 to 2018 part of the Nova litigation case, which will come in there.

We're doing a lot with all the businesses and functions on what we can do for efficiency. So in fourth quarter, leveraged services in Dow was down 13% in terms of cost. So they're wringing a lot of efficiencies out. Digitalization will help that, and I think that will be a difference. I'll throw it to Howard. Do we have a number on Texas-9 and on Canada?

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

Well, we didn't give a number this morning on the Canadian except for the capacity, John. So what I would say is you take 130,000 tons of ethylene, we're going to use our portion of that. We're not all of that. We're going to use our portion of that to make additional polyolefin. We've got the reactor capacity already there, and so that's going to be the primary focus.

The other thing that I would say that wasn't in Jim's list is $1 billion of cash that we'll get back from the lower transaction costs. We spent almost $1.2 billion in cash last year to finish the DowDuPont spin -- spinout for Dow, and that -- we'll get $1 billion of that back this year and then another $200 million in 2021.

Operator

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

Neal Sheorey *Dow Inc. - VP of IR*

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

Operator

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

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