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PRESENTATION

Operator

Good day and welcome to the Dow Third Quarter 2020 Earnings Call. (Operator Instructions) Also, today's call is being recorded.

I would now like to turn the call over to Colleen Kay, Vice President, Investor Relations.

Please go ahead, ma'am.

Colleen Kay ***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.

I'm Colleen Kay, Investor Relations Vice President for Dow, and joining me on the call today are Jim Fitterling, Dow's Chairman and 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 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 begin with the third quarter highlights and discuss the operating performance of the segments. Howard will share an update on our progress against the actions we are taking to further enhance our financial strength and then provide our market outlook and modeling guidance. Jim will close with some remarks on Dow's progress towards our

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sustainability targets and our competitive position for growth. Following that, we will take your questions.

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

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

Thank you, Colleen, and thanks to everyone for joining us. On behalf of the Dow team, we hope that you and your families are healthy and safe.

Starting on Slide 3. In the third quarter, the Dow team delivered strong operating cash flow in line with the year ago period despite lower earnings as a result of the pandemic. As the global economy began a gradual recovery, we captured demand growth from second quarter lows across all segments. Our polyethylene business achieved 3% volume growth year-over-year. And on a sequential basis, total company volume increased 9%, with all businesses and regions achieving demand gains. We saw strength across furniture & bedding, appliances, packaging, construction and automotive end markets. These results enabled us to deliver revenue that exceeded our original guidance and a more than 700 basis point improvement in operating EBIT margin versus the prior quarter. Sequentially, every segment and business posted margin gains, led by the polyurethanes business and the Packaging & Specialty Plastics segment.

Dow generated solid cash flow, delivering $1.8 billion in cash flow from continuing operations. Free cash flow was $1.5 billion, up more than $150 million versus the same quarter last year, continuing our track record of improvement every quarter since spin on a year-over-year basis. Our cash flow conversion was 119% versus 96% in the same period last year.

We returned $518 million to shareholders through our industry-leading dividend and continued to reduce net debt by approximately $1.1 billion in the quarter, down a total of more than $1.8 billion year-to-date. These results were underpinned by the early actions we took at the beginning of the pandemic, which enabled us to benefit from the start of the recovery.

Last month, we announced details on our restructuring program, which will deliver $300 million in annual structural cost improvements. We finalized the sale of our North American rail assets in September and announced a second infrastructure divestment for select U.S. Gulf Coast marine and terminal operations. Both actions are aligned with our best-owner mindset and are expected to deliver total cash proceeds of nearly $1 billion by year-end.

We also enhanced our financial flexibility, increasing our cash and committed liquidity to greater than $13.5 billion and improving our liability profile with a $2 billion debt-neutral bond issuance. We now have no substantial long-term debt maturities due until the second half of 2024. And we are on target to deliver on our previously committed 2020 operational expense reduction of $500 million.

Finally, we advanced our efforts in sustainability to create new opportunities for growth, drive innovative solutions for our customers and increase efficiencies throughout our operations. Dow's discipline and focus on capturing value from the unfolding recovery has positioned us to keep building on our strong performance, further enhancing our competitiveness and advancing our ambition.

On Slide 4, I'll provide a review of our segment results. The improving economy, though uneven, allowed us to increase our operating rates across the enterprise, which are now approaching first quarter levels. Operating EBIT for the enterprise increased by $704 million sequentially. Volume in the Packaging & Specialty Plastics segment rose 1% year-over-year as plastics demand remained resilient and our year-to-date polyethylene volumes exceeded the same period in 2019.

While company net sales declined 10% versus the year ago period primarily driven by lower global energy prices, Packaging & Specialty Plastics segment price increases supported a 14% improvement in sales versus the prior quarter. Operating EBIT was $647 million, down from the year ago period as targeted expense reductions and volume gains were more than offset by overall margin compression. However, on a sequential basis, the segment grew operating EBIT by $329 million and expanded operating EBIT margins by 630 basis points driven by solid consumer and industrial sector rebounds.

The Packaging and Specialty Plastics business captured strong year-over-year demand growth in flexible food and specialty packaging; infrastructure, consumer and transportation packaging; and health and hygiene applications. And compared to the prior quarter, the

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business delivered local price gains in all regions and double-digit gains in the United States, Canada and Latin America.

Moving to the Industrial Intermediates & Infrastructure segment, operating EBIT was $104 million, down from the year ago period due to weaker demand and margin compression. On a sequential basis, the segment grew operating EBIT by $324 million and expanded operating EBIT margins by more than 1,200 basis points driven by significant volume recovery in polyurethane applications as demand rose for durable goods and construction end markets.

The Polyurethanes & Construction Chemicals business reported a net sales decline year-over-year despite benefiting from demand growth in furniture, bedding and appliances. Compared to the prior quarter, the business delivered double-digit volume growth in nearly all regions with particular strength in consumer durables, construction and automotive end markets. As a result of rising demand, we increased operating rates by approximately 20% over the second quarter.

The Industrial Solutions business reported lower net sales versus the year ago period driven by decreased local prices and volume. Sequentially, the

business captured increased demand, primarily from solvents and intermediates, as industrial markets began to recover.

And finally, the Performance Materials & Coatings segment reported operating EBIT of $75 million, down year-over-year primarily driven by margin compression in merchant siloxanes and reduced demand due to the pandemic. However, sequentially, the segment grew operating EBIT by $48 million and expanded margins by 220 basis points, led by demand recovery in formulated silicones products and coatings.

The Consumer Solutions business reported a decrease in net sales versus the year ago period. Continued resilient demand in home care applications was more than offset by weaker demand year-over-year in automotive, construction and high-end personal care as a result of the pandemic. Compared to the prior quarter, the business delivered volume gains as industrial manufacturing activity, high-rise building projects and mobility and transportation began to improve.

The Coatings & Performance Monomers business achieved volume growth in all regions except the United States and Canada, which were flat versus the year ago period. Demand increased in architectural coatings as residential construction market dynamics strengthened and consumers continued do-it-yourself projects. As a result, the business captured sequential double-digit gains in nearly all regions.

Turning to Slide 5. Our feedstock flexibility was again a key enabler of margin expansion, contributing to sequential operating EBIT margin improvement in the quarter. Feedstock costs were higher than anticipated entering the quarter. However, our flexibility and agility to optimize feeds in real time, asset-by-asset and furnace-by-furnace allowed us to capitalize on our cost curve advantage and drive incremental margins. We purposely built this capability, both people and assets, around the world over many decades to take advantage of raw material and co-product market dynamics.

On the U.S. Gulf Coast, ethane and propane have been the cost-advantaged feeds for more than 90% of the time over the past decade. Dow's leading ethane and propane flex capabilities and our ability to reduce naphtha to 0 have given us a competitive advantage. This is especially true in these volatile derivative markets, which have constrained operators who are more reliant on naphtha. Altogether, this will continue to drive substantial value for Dow not just in North America but also in Europe, where Dow's LPG range is 4x greater than the industry's. And these advantages extend to Dow sites in Argentina, Canada and at our joint ventures in Asia Pacific and the Middle East, where we have optimized mixed-feed cracker capabilities. Dow's feedstock flexibility advantage is reflected in the strength of our margins as showcased in our annual benchmarking results.

And with that, let me hand it over to Howard for more color on our financial results.

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

Thanks, Jim, and good morning, everyone.

Moving to Slide 6. Through 2020, we have continued to improve our liquidity and liability profiles, execute against our unique cash levers and strengthen our competitive cost structure. Our discipline delivered a cash flow conversion of 117% on a trailing 12-month basis, which has more than doubled since spin. This cash generation has further strengthened our financial profile. We increased total cash and available committed liquidity by $1.5 billion at quarter-end to more than $13.5 billion, representing a 28% increase over the end of 2019. Over the same period, we also reduced net debt by $1.8 billion with an in-quarter reduction of $1.1 billion.

As Jim mentioned, we also continued to prudently manage our liability profile as well. We extended our next substantive debt maturity out by another year, now to mid-2024, with a debt-neutral bond issuance in the quarter.

This disciplined approach to prioritizing cash has enabled us to continue to improve our balance sheet even through the pandemic, something that has been a challenge to many in our industry. In fact, our best-in-class free cash flow yield and conversion rates have driven a further reduction in our net debt-to-cap ratio since year-end 2019, reflecting our improved leverage and positioning us well for the recovery.

We also continued to advance our unique-to-Dow cash levers, which are set to deliver over $1.5 billion in discrete cash tailwinds for the year. Entering the third quarter, we had already delivered more than $700 million in cash. We were able to close our rail infrastructure asset sales 3 months earlier than originally planned, resulting in a cash proceeds of more than $300 million. And we announced plans to divest select marine and terminal infrastructure assets. The targeted close for this transaction is early December, with more than $600 million in cash proceeds expected.

These transactions strategically targeted nonproduct-producing assets and demonstrate our best-owner mindset and culture of benchmarking while locking in long-term, cost-advantaged access to these services.

Early in the year, we took additional actions to further streamline our cost structure and boost our competitiveness in response to the COVID-19 pandemic. Last quarter, we increased our 2020 operating expense reduction target to $500 million, and we are on track, having delivered approximately 60% year-to-date.

And our focus on releasing cash from our balance sheet has resulted in a decrease of more than $700 million in working capital over the last 12 months. This has been aided by our structural working capital interventions, which contributed to the $137 million release of cash for the quarter even with sequentially higher sales. And we will continue to target additional structural working capital improvements going forward.

We also finalized our restructuring program in the quarter, recording a $575 million charge comprised of severance, exit and disposal activities and asset write-downs. With a 2-year payback period, the program is expected to deliver total annualized EBITDA savings of more than $300 million, achieving a run rate of 50% by mid-2021 and substantially complete by the end of 2021.

The asset shutdowns target primarily small-scale production facilities as we continue to balance supply to regional needs and will not impact our ability to meet customer demand.

Altogether, our actions are producing increased financial flexibility and enhancing our competitiveness as the economic recovery gains momentum.

Now moving to Sadara on Slide 7. Consistent with the growth captured in our core packaging and polyurethane businesses from the ongoing economic recovery, Sadara is also benefiting from end market resilience and market supply tightness. As a result, the JV's financial and operational performance continues to improve with an equity earnings uplift of approximately $100 million year-over-year. And Dow's expected contribution for 2020 has now been reduced by 20% to no more than $400 million. In addition, the structural

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changes that will be implemented to enhance Sadara's long-term feedstock flexibility through additional ethane and an extension of natural gasoline lean allocation will improve its position on the global cost curve.

Dow, Saudi Aramco and Sadara continue to make good progress toward debt reprofiling with the lenders. We remain on target to have an agreement to reprofile Sadara's project financing debt by year-end.

Turning to our market outlook on Slide 8. In the first half of the year, we took aggressive action in response to the pandemic to reduce production to match demand, well ahead of the industry. The economic recovery has generally progressed as we expected. However, the pace in the third quarter, particularly in durable good end markets, was faster than anticipated. In response, we quickly increased operating rates by double digits across the enterprise from the June low. This deliberate approach has enabled us to build cash and reduce net debt.

Going forward, Dow is positioned to capture significant upside as the economic recovery strengthens. Indicators are signaling stabilization in key markets and geographies. PMI, for example, has increased across China, EMEAI and the U.S. and the U.S. housing market is up 20% year-on-year. The underlying demand trends, combined with continued low inventories, are leading to tight market conditions, which presents additional opportunity for our portfolio to ramp our operating rates higher.

Turning to our modeling guidance on Slide 9. Moving to the fourth quarter, we expect the economic recovery will continue to improve, driving sequentially higher business results but tempered by typical seasonality, which has historically been anywhere from a 3% to 5% sequential impact on sales and a 5% to 10% impact on EBIT. For modeling purposes, we suggest you use the midpoint of those ranges. And as the quarter progresses, if things materially change, we'll be sure to provide an update.

We see total sales in the range of $9.5 billion to $9.8 billion. The strength we saw in the third quarter in key value chains like polyethylene and isocyanates is expected to continue as durable good end market demand further rebounds and packaging demand continues to be resilient.

As usual, we're highlighting the key EBIT drivers in the quarter on a sequential basis. In the Packaging & Specialty Plastics segment, we expect the robust, consumer-driven purchasing behaviors to continue for our packaging applications. And with industry inventory levels at 5-year lows, we see support for the recently nominated October price increase.

In the Industrial Intermediates & Infrastructure segment, continuing demand recovery in the automotive, construction and furniture and bedding markets should continue to support price increases in the fourth quarter with some offsetting seasonality.

And finally, in the Performance Materials & Coatings segment, as usual, normal seasonality in the Northern Hemisphere will be a headwind for coatings in the quarter. However, orders in automotive, electronics and construction end markets should provide demand gains for our differentiated silicone offerings.

We do expect a $100 million higher turnaround spend sequentially as we had a delay from the third quarter due to the hurricanes on the U.S. Gulf Coast. However, we are still on track to lower our turnaround costs by $100 million for the full year versus 2019 and deliver our $500 million expense savings as well.

I'd like to emphasize that this near-term guidance is based on our assumptions for a continued, yet uneven recovery. We expect the rebound off the first half lows that benefited our third quarter results to continue, growing at a moderate pace through the fourth quarter, absent any significant second-wave pandemic impacts. We remain confident that the decisive actions Dow has taken this year will continue to differentiate us in that environment.

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

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

Thank you, Howard. Please turn to Slide 10.

In addition to our strong financial performance throughout this turbulent year, Dow also launched breakthrough sustainability targets earlier this year focused on reducing our carbon footprint and addressing plastic waste.

Sustainability is not a new concept at Dow. In fact, for decades, it has been a defining factor in how we make decisions, run our operations and innovate new products. These new targets reflect our longstanding commitment to apply our material science expertise to address the world's most pressing issues.

We announced our intention to reduce Dow's net annual carbon emissions by 15% by 2030 and achieve carbon neutrality by 2050. New enabling process technologies will bring carbon efficiencies to our operations and provide higher earnings, such as our FCDh technology being scaled up at our cracker in Plaquemine, Louisiana, as well as increasing Dow's renewable energy purchases at very competitive costs across the United States and Latin America and accelerating technology to electrify ethylene steam crackers.

We also continuously innovate new products and solutions to help our customers meet their sustainability commitments and lower their carbon emissions. For example, our SunSpheres BIO SPF Booster and MaizeCare Style polymers are products that meet our customers' requirements for more sustainable personal care solution.

Secondly, we announced several actions to further our leadership role in driving a more circular economy. By 2030, that will Dow will help to stop the waste by enabling 1 million metric tons of plastics to be collected, reused or recycled through direct actions and partnerships. For example, our work with partners around the globe to construct infrastructure like polymer-modified asphalt roads and to make products with post-consumer recycled plastic.

And by 2035, we will close the loop, enabling 100% of Dow products sold into packaging applications to be reusable or recyclable. We are developing circular economy solutions, such as investing in advanced recycling and offering recycled plastics with our recycle-ready technology, as part of our product portfolio.

We are already seeing the benefits of our actions as the market adoptions for these new solutions continues to grow and enable us to drive lower costs and higher sales throughout our businesses. Sustainability will continue to be a critical driver of long-term value for Dow and our shareholders.

In closing, on Slide 11, our strengthened financial flexibility, disciplined focus on cash and the actions we have taken to reduce structural costs position us well to continue delivering value for Dow and our shareholders. Most of our markets have already seen significant improvement. And as the recovery broadens, we will begin to see higher margins as differentiated parts of our portfolio return to more normalized growth.

Our functional polymers, polyurethane systems and silicones businesses, as highlighted in our annual benchmarking, deliver premium margins and represent significant EBITDA and margin uplift as social and workplace activities resume and durable goods demand continues to increase.

In the meantime, we remain focused on strengthening our financial position, unlocking additional cash upside and successfully reprofiling Sadara's debt. This financial flexibility will further enhance our competitiveness as we move forward, affording us an ability to seize the right opportunities for growth.

We are also advancing Dow's commitment to ESG as we pursue our long-term ambition to become the most innovative, customer-centric, inclusive and sustainable materials science company in the world, driving long-term growth as consumer demand rises for innovative, more sustainable solutions.

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These actions are underpinned by a unique consumer-focused portfolio that has broad geographic product and market reach as well as industry-leading feedstock flexibility. Combined with our focus on low-capital-intensity investments, digitalization and innovation, we will continue to drive superior performance relative to our peers.

Now I'll turn it back to Colleen to set up the Q&A.

Colleen Kay ***Dow Inc. - VP of IR***

Thank you, Jim. Now let's move on to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question, we'll hear from David Begleiter with Deutsche Bank.

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

Jim and Howard, in terms of your capital allocation, as your strength has improved, especially with the debt refinancing, you have a lot of free cash over the next 2, 3 years. How do you expect to use that cash? It could be buybacks. It could be some bolt-on M&As. It could investing in the business organically.

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

Thanks for the question. And obviously, we've done a great job managing cash and delivering cash from machine. And as you say, we've paid down about $2 billion of debt this year. So as we look at next year and the next couple of years, we're working on scenarios where we could be able to, with discipline, increase that CapEx from the $1.25 billion that we have this year. Most of that $1.25 billion is going to safely and reliably operate the plants today and growth capital in downstream businesses like in our Industrial Solutions business, polyurethane systems and formulated silicones businesses.

As we free up a little bit more CapEx, it's going to go into quick-payback projects. Especially, anything that hits reliability and really improves things like cracker reliability come to the bottom line pretty quickly. So you should see that. And then once we get back above COVID demand growth levels, we'll start to look at more downstream CapEx investment. But I would say we'll open it up gradually, and we'll ramp it as we see the demand improve.

As far as M&A, I would think any bolt-on M&A would be relatively small. I don't know, Howard, if you want to comment on that.

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

Yes. No big bang M&A, Dave. And I would say that in addition to continuing to support our leading dividend, we also want to continue to delever. So we haven't set a target yet for next year. We're ahead of pace this year, as you pointed out. We'll set a target, I'm sure, on the next earnings call. But it'll be in the $500 million to $1 billion range as a first pass based on what we see today.

Operator

Next, we move to Jonas Oxgaard with Bernstein.

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

I have a 2-part, if you don't mind, on Sadara. I'm looking at the closures you had, and you're talking about $400 million cash in. If I'm looking at the combined EBITDA, even if I assume Q4 is the same as Q3, it's only about $160 million with $250 million of interest, and your debt is not going down. So my first part of the question is, where has all that cash gone? Is that to do the changes in the plant that you're talking about?

And then second part of the question is, how should I think about 2021 here then? You're talking about cash -- sustainable cash flows, which I'm assuming means 0 cash-in from Dow. How do you plan to get there? Because that seems to require a pretty significant increase in EBITDA for '21.

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

Yes. Jonas, I'm going to let Howard unpack it. But just remember, the cash that's going into Sadara is our portion of the principal repayments on the project financing, which is why the debt reprofiling by the end of the year is a big target for us.

So Howard, why don't you unpack like the EBITDA recon and also progress on how we're doing on debt reprofiling?

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

Yes, Jonas. Look, I think the way -- let me start with Sadara's operational performance. And I would say that they're on -- their third quarter numbers were a $100 million improvement from an equity earnings perspective versus the same quarter a year ago. They also saw sequential improvement. And I would also say that they are on track right now to have a better 2020 than 2019, which I would say most folks in our industry can't say that. So I think their operational performance is doing very well. They've taken costs out. Obviously, they're also benefiting from the snapback in demand that we've seen in the durable goods areas, in the urethane chain as well as the resilient demand that we've seen in our core business in packaging.

When you think about where the money is going, Jim hit it on the head, which is, remember, right now, it's project financed. Project financing means they've got about $1 billion of principal that are coming due every year. So that money is going to principal paydown. That's why we're so focused on the reprofiling. And I would tell you that we made really substantive progress with the ECAs that are in the syndicate in the third quarter. We're now in the process of engaging with the commercial lenders and the Sukuk investors, and we remain on track to get a deal done by the end of the year. So we're feeling really good about that.

And remember, that reprofiling -- our target on reprofiling is for Sadara to be in a position of cash flow self-sufficiency by January 1. And so that is the thought process, and we're on track to make that happen. We don't have it done. We still have work to do but watch this space. I'm really pleased with the team. We got Saudi Aramco, Sadara and the Dow treasury teams that are working collaboratively with each of the lenders and the lending syndicate. So more to come but good progress so far.

Operator

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

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

Building on your comments about the strength in polyethylene markets and your expectation for pricing in October, maybe you could just help us understand how you're anticipating the balance of the quarter playing out. Normally, in November and December in particular, we tend to see some price declines. So do you think those will be -- there'll be price declines? Or do you think that the demand strength that you're seeing there is robust enough to keep those at a minimum despite the fact that there's a good amount of Chinese capacity coming? And then just what's your expectation for ethane as these new crackers -- sorry, as these -- as crackers restart post the hurricane outages?

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

Good question. And let me -- I'll take PE first and then I'll come back to ethane.

I think one of the reasons we had a better performance in third quarter was demand was stronger for longer than we expected and inventories were lower than anybody expected. We also had higher operating rates at Dow but also throughout the industry. And we did have some impact from quite a bit of capacity off-line as we entered the third quarter.

My expectation is demand is going to continue to be strong. It's been stronger. Polyethylene demand has been stronger year-over-year, every month, all year long, even through the second quarter, which was a very sharp downturn. So I think that bodes well for pricing through the quarter. And I think our average price through the quarter will probably tick up slightly. Remember, it started low and it ended up about $0.12 through the quarter in the third quarter in the U.S. I would say we'll hold on to that and maybe tick up slightly on average for the quarter.

On ethane, there's been a lot of speculation on what's going to happen with ethane. I would say natural gas looks to me like it's going to

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stay about where it is. It might rise to as much as $3.50 through the winter, but I don't see anything that would indicate that there's going to be a big spike up in natural gas. And on ethane, you have to remember that frac spreads, as they improve, bring a lot of ethane to the market. What we saw in June and July, frac spreads got up to $1.50, 1 million Btu, and that was enough to bring 300,000 barrels per day of ethane to the market.

So I expect frac spreads will increase a little bit. We might see ethane prices bump up a couple of cents in the fourth quarter from where they've been. But as those frac spreads increase, people are going to bring some more capacity into the market.

Operator

And next, we'll move on to Jeff Zekauskas with JPMorgan.

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

In your geographic description of your growth, I thought the results were different than what I would have expected in that in the U.S. and Canada, your volumes were down 9%; in Europe, they were up 4%; in Asia, they were flat. And I would have thought that Asia would have been stronger and Europe weaker, maybe the U.S. stronger. Can you talk about those overall trends and whether you expect them to continue?

And then quickly for Howard. Accrued and other liabilities moved from $2.7 billion to $3.4 billion in the quarter sequentially. What's a normal number for accrued and other liabilities for Dow?

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

I'll take the geographic question. I'll let Howard talk about the liabilities.

I would say the recovery is probably more market driven globally than it is geographically driven. We've seen similar patterns in all the geographies on what's coming back in the market. So food and specialty packaging, industrial packaging. We saw a big tick-up in construction. We saw durable goods, electronics all up, appliances up. And we saw that across all the markets. We saw automotive make a big comeback.

I would say what you get into region-by-region would just be differences that you might see in a region. For example, siloxanes was a bit slow in the third quarter in Asia, and we have a pretty sizable footprint there. And then polyurethanes, obviously, has a big footprint in Europe. And while it ticked up globally, we still have some room there to grow. I wouldn't read much into it from a geographic standpoint.

I think the markets are continuing to improve. I think Latin America probably made one of the stronger snapbacks that we saw, especially Brazil, in the third quarter. So we're keeping an eye on that, but it's really more market driven.

And Howard, do you want to touch liabilities?

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

Yes. Jeff, great question. I'm impressed with your diligence in the back of our press release.

Look, I would say that the $3.4 billion number has definitely increased. The biggest driver is the restructuring, right? So we announced the restructuring of 6% of our labor cost. And so we accrued in the quarter for all of the charges, and that obviously comes into the accrued and current liabilities.

The other item is with the higher performance, there's a slight increase in the performance comp expectation. That's an annual bonus program. We'll see how the fourth quarter turns out. But those are the 2 big drivers of the increase.

So that $3.4 billion number will move around. But as you get through 2022 and 2023, it'll come down by about $300 million, which was the biggest chunk of the step change because of the accrual.

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Operator

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

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

And impressive quarter. And it came in 18%, 19% higher than the guidance that you offered in the middle of September. So obviously, you ended the quarter on a tear.

Can you talk a bit more about how that surprised you? And here we are 3 weeks into the fourth quarter. How sustainable is that higher level of performance?

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

Yes. Thanks for the question. And I would say a few things that changed. We had expected to have turnarounds in the third quarter. And because of the hurricanes, turnarounds came in lower by $50 million in the quarter. Now some of that slides now into the fourth quarter because we had to take the plants down. And we had about $200 million of improved polyethylene and isocyanates pricing strength between when we guided and the end of the quarter. So I think those are the 2 big things.

The other thing I would say, and just credit to team Dow, fantastic job of blocking and tackling, price volume management and running the assets. We moved quickly in second quarter to take operating rates down to match demand and manage cash and liquidity, and we did that really well. And then we brought them up quick as we saw in third quarter that things were improving. And I think we capitalized on both ends of that curve.

And so -- and then on top of that, we were a little bit lucky, too, we have to say that, that we did not get a direct hit from the hurricane. So we were able to navigate through that and get the plants back online relatively quickly. Those would be the big moving parts.

Operator

Next, we have Bob Koort with Goldman Sachs.

Robert Andrew Koort ***Goldman Sachs Group, Inc., Research Division - MD***

Jim, I'm wondering, with such volatility in regional margin pads for the polyethylene business over the last year, do you see ramifications sort of broadly on future expansions? Do you think this is going to chill some ambitions globally? Or can you give us some perspective on how you see this next wave of polyethylene that might come into the market over the next couple of years?

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

Yes. Good question. I think it has chilled some substantially, and I think it will continue to chill some more. And on top of what you talked about on demand, you've got to remember there's a lot of pressure on the industry right now to be able to get carbon reductions and get CO_2 emissions down.

So as you continue to bring on new capacity, people are going to look at that new capacity and they're going to look at your carbon footprint and try to determine what are you doing to your total carbon footprint. And it's one of the reasons that we're working on about 4 technologies in the process technology side, in the ethylene production and propylene production areas that are all geared towards being able to build future plants that could potentially be 0 carbon crackers and also being able to retrofit existing plants where we might be able to get a 20% to 40% reduction in CO_2 footprint. So we're doing that for ourselves, but we're also doing that because we think that could be a revenue and licensing stream for us going forward.

So I would stay tuned, but I think you're starting to see people pull back a little bit on projects. And that's why we pivoted pretty quickly to manage cash and liquidity through this so that when we get through the pandemic, we come out with a strong balance sheet and we have the capability and the flexibility that we need to not only grow but to do it in a way that helps bring that carbon footprint down.

Operator

And John Roberts with UBS will have our next question.

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

Two of the contributors to polyethylene strength, I think, were low channel inventory going into the recession and a temporary switch away from recycled plastic towards virgin. Have inventories normalized in the channel? And are you seeing any signs of a move back towards recycled?

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

I would say inventories at the end of third quarter continued to be low. In fact, they probably went down at the end of the quarter from where we started at the end of second quarter. So I don't see any change there.

And on virgin plastics, John, I think today, with recycle rates, and we see this as well, when people are looking to recycle plastics back into new materials, it's requiring virgin materials to blend with that capability. So I don't think recycling necessarily displaces all the virgin material. I think you still need plenty of virgin material to make the quality that you need for that end spec. I think that'll change over time, but there isn't going to be an impact over the next couple of years.

Operator

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

Prashant N. Juvekar ***Citigroup Inc., Research Division - Global Head of Chemicals & Agriculture Research and MD***

I have a quick question on siloxanes. It's weak due to excess supply in siloxanes. So how quickly can you get your merchant siloxanes into downstream silicones? And would that cause overcapacity in silicones?

And my second question is, you talked about best-owner mindset. You've done some divestitures here. Would Sadara be a long-term holding for you post your bank agreements?

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

Yes. P.J., on the siloxanes question, I think the real issue is just addressing the merchant siloxanes capacity. So we've done some things, obviously, to take some of that capacity idle, and that was part of the third quarter charge that we put in there. So we're going to idle a little bit of capacity in siloxanes.

For downstream silicones, very diverse markets. I think we can continue to invest in downstream silicones, formulated silicones investments, and continue to chew up that merchant siloxanes business without getting into an oversupply situation. So we see it in automotive, we see it in construction. All very strong. It goes into appliances, it goes into all kinds of food packaging and specialty packaging. So I think you're going to see there are plenty of growth areas for the downstream silicones without really overpowering that.

And as for Sadara, first things first. Our goal here is to get Sadara refinanced and get that $500 million a year off, so a $500 million cash improvement every year for Dow. And then when we get past that, we'll start to have a look at long term what do we think can happen.

Sadara is improving. You can see it in the rates in third quarter. And we're not at cycle averages yet in terms of EBITDA growth. So this is what Sadara can do at some pretty low levels. We've probably got another 20% up before we get to cycle averages on EBITDA, and we'll take that into account and look through the cycle and what the outlook is before we get into any discussions about that.

Operator

And next, we'll move to Steve Byrne with Bank of America.

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

I wanted to drill in a little bit more on this $300 million cost savings initiative. How much of that would you say is actual headcount reduction versus workforce costs like T&E? And the other bucket could be the asset rationalization. What do you think the net benefit could be in 2021 in COGS and SG&A?

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

Howard, do you want to take that and kind of unpack what the costs are?

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

Yes. And look, I would say from a hard dollar savings standpoint, you should expect about $150 million to drop to the bottom line in 2021 and then the balance of the $300 million, another $150 million, in 2022. It includes a 6% reduction in our workforce costs. So that doesn't mean 6% headcount. I mean obviously, we're trying hard to trim the high end of the pyramid. Obviously, we're also looking at just streamlining.

When you think about it from a segment-level perspective, it's about a little bit more than 1/3 in P&SP and then the balance split between industrial intermediates and performance materials and chemicals.

Operator

And we'll move on to Laurence Alexander with Jefferies.

Laurence Alexander ***Jefferies LLC, Research Division - VP & Equity Research Analyst***

I have a question about the costs or burdens from your ESG initiatives or the direction you're going. I guess could you touch on your current thinking about the CapEx or return on capital on recycling versus virgin plastic?

And for the carbon-neutral targets, how disruptive would it be for Dow to pull forward that target by, say, 10 or 15 years if that's the direction the political winds end up blowing?

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

Yes. Let me talk a little bit about -- on the carbon side.

Clearly, the source of carbon emissions comes from generation of power, burning natural gas and burning natural gas in the furnaces and the cracker.

On energy -- alternative energy, we have a target to create -- to contract as much as 750 megawatts of alternative energy, wind and solar. And most of that is competitive or less expensive than what we produce today. So that has a net value-add to it.

Obviously, we can't do everything, and there becomes a limit on what I can do with wind and solar because I need 24/7 available dispatchable power and I need steam. And so as we look at the future growth, we're looking at cracking and process technology around FCDh, which is a way to make propylene out of propane, and do it with about a 20% lower carbon emissions. And that, I think, can be equal to or better than return on capital than what we typically approve in our projects.

We're also working on, and these are all smaller dollar right now, pilot-scale activities. We're also working on that same technology for ethane to ethylene. It's obviously a little bit tougher to make that happen. That could be as much as a 40% reduction in CO_2 footprint.

Obviously, pulling things forward will depend on those technologies proving themselves and then looking at the total capital that we have to spend over time to make that happen. And as you know, some of these assets are very profitable, so you want to have a game plan for how you do this over time.

I would say the other area that we've got to be sensitive to is that -- on the recycling side is recycling is going to need public policy as well as recycling targets to make things happen. One of the reasons it doesn't happen today is because it's more expensive to recycle than it is to make virgin material. So one of the things we're working on around the world, Europe, United States as well, is what does the policy need to look like.

In a linear economy, the cheapest thing to do is for your plastic waste to go to a landfill. And obviously, if we stay in a linear economy, we run the risk that there's more plastic waste ends up in places like the ocean. If we want to close that, we've got to create the right

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incentives to close that loop and bring it back in. There's technology to do it today. More than 80% of what we make today can be completely recycled, but it isn't. And that really has to do with local policies and costs, and we've got to tackle that issue.

Operator

And we'll move on to Christopher Parkinson with Crédit Suisse.

Kieran Christopher De Brun ***Crédit Suisse AG, Research Division - Research Associate***

This is Kieran on for Chris. I was just wondering, demand for polyurethane has clearly improved substantially in this quarter. I know it's a little bit early, but can you discuss any preliminary demand trends you're seeing in 4Q and maybe how you view 2021 versus 2019 demand levels? That would be helpful.

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

We saw double-digit volume growth quarter-over-quarter, and it primarily was driven by consumer durables, appliances, construction and automotive end markets. So they're up, although some of them are still below last year's levels. Automotive, for example, is up, but it's still below 2019 levels. I think it's going to continue. Appliances are still very, very strong, and there's a lot of backlog on appliances.

And the supply chains -- after what we went through in second quarter and into third quarter, the supply chains are tight in some areas. So you're seeing a lot of backlogs, and we're catching up with that demand. So I think it's going to continue through fourth quarter for sure. And then we'll keep an eye on how it goes beyond that.

China, I would say, already, in almost all markets, has returned to pre-COVID levels. And so we may actually start to see overall growth in China, which would be good.

I would say some markets in the rest of the world like appliances, like packaging are at pre-COVID levels but not all. In automotive, it's still shallow to pre-COVID levels and probably will be for a couple of years, I expect.

Operator

And we'll move on to Kevin McCarthy with Vertical Research Partners.

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

Jim, just to continue the dialogue on polyurethane, so I was curious to hear your thoughts on the supply side. We've seen a number of force majeure declarations. Can you speak to where you think inventory levels are in MDI and polyols as well as operating rates and prospective pricing outlook in the chain?

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

Yes. Things are tight as a drum right now on MDI and propylene oxide. I'd say polyols may be a little bit better, but it's propylene oxide that's pretty tight right now. And I think that's going to continue.

Obviously, when you have an upset in isocyanates operation, you want to get it back as soon as you can, but it sometimes takes a while to get back up and get lined out. So I think things are going to be tight through the fourth quarter. Could extend into the first quarter.

We're managing. We're working very closely with customers to try to keep them running and try to keep enough allocation to everybody so that we can support them through. But it's a lot of heavy lifting by the team right now.

Operator

And we'll move on to Arun Viswanathan with RBC Capital Markets.

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

I guess I just wanted to get your thoughts. A similar type of question, but there's been some chatter of potential restocking in certain end markets maybe the first half of '21. I guess would you agree with that? I'm just curious just because it seems like some of your markets, you're back to normal levels maybe in construction and so on. And you mentioned China is kind of back there. But maybe if you can touch

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on automotive and construction in some of these areas. Do you expect more restocking in the first half of next year? Or are we kind of back at normal levels?

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

Arun, I'm not sure I would characterize it as restocking or just getting back to target levels of supply. I think we've dipped in, in some of the supply chains below target inventory levels, and that's made them -- the supply chains less robust. And on top of that, you've got global trade issues, which really complicates some of the supply chains as well.

So I think people would like to get back to normal inventory levels. I'm not sure I would call that restocking or stocking up. I think just get back to a more resilient supply chain because we're doing this today and has taken a toll on people.

The second thing I would say is that coming out of COVID, we're pivoting to more digital capabilities. And one of the things that we're able to do with digital channels is have better line of sight to market demand, and we're able to match operating rates to demand.

And so I think you're going to see a change in behavior in terms of how people operate, that they're going to have a much better visibility on the demand side and they're going to be able to titrate that. And so you won't see big swings up and down in inventories. You'll see things be more tightly managed, especially in a period of time like this where cash is king and you need to focus on cash and liquidity.

Operator

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

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

So maybe a bit of a follow-up to what you were speaking to earlier.

On the Packaging & Specialty Plastics area, when I look at the outlook that you guys have for 4Q versus 3Q, the flat to up 3% or so, I guess to me it seems like something's missing here because the pricing looks like it should be solidly better than that. The demand environment, given low inventories, also sounds like it should be at least a modest improvement. So are there other puts and takes that we should be considering? Or is it just a conservative outlook? I guess how should we be thinking about that?

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

Yes. And remember I talked about the turnaround. So the turnarounds that were in third quarter that got moved into fourth quarter are going to hit Packaging & Specialty Plastics segment. And so they get most of that $100 million cost.

You can add back -- we had about a $50 million impact in the third quarter from Hurricane Laura, and you can add that back. So $100 million of turnaround costs, take $50 million off of that. So you've got that which is weighing on it. And then we're expecting ethane price to go up a couple of cents during the quarter. Those are the biggest moving parts.

Operator

And next, we'll move on to Jim Sheehan with Truist Securities.

James Michael Sheehan ***Truist Securities, Inc., Research Division - Research Analyst***

Just on your sustainability initiatives. What are the incremental costs of reducing the carbon emissions and collecting the 1 million tons of plastics for recycling by 2030? And on close the loop, would that increase or decrease your mid-cycle EBITDA? And roughly by how much?

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

Jim, I don't know that I would characterize the carbon reductions as incremental costs. I think as you look forward, it will be reflected in where we decide to spend our capital spending and how we decide to improve those assets.

We want to do this in a way that's neutral or positive to the company's results. That's why we're focusing in on process technology and

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catalysis as a way to do it. And those are the near-term improvements that we're looking to make.

And also, remember that we have older assets in the fleet. And so some of those that are at end of life have some of the higher carbon intensity and carbon footprints. So what we decide to do with older assets can have a big impact as well.

On closing the loop, it isn't like we're going to pay to close the loop in the marketplace. There is market demand for recycled materials. And so we're working with partners to create innovative solutions to make that happen, and we're working with the marketplace to get the capital markets involved. So we're working with people like The Recycling Partnership, Closed Loop Partners, and we're trying to come up with business models that in and of themselves are sustainable and that will allow that plastic to come back in and, in some cases, get blended with virgin plastics to make the final end product.

Operator

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

Colleen Kay ***Dow Inc. - VP of IR***

Thank you, everyone, for joining our call today. We appreciate your interest in Dow. For your reference, a copy of our transcript will be posted on Dow's website within 24 hours.

This concludes our call. Have a great day.

Operator

And that will be the end of today's call. We thank you for your participation.

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