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PRESENTATION

Operator

Good day, and welcome to Dow's First Quarter 2021 Earnings Call. (Operator Instructions) Also, today's call is being recorded.

I would now like to turn the call over to Pankaj Gupta. Please go ahead, sir.

Pankaj Gupta

Good morning. Thank you for joining Dow's first quarter earnings call. This call is available via our webcast, and we have prepared slides to supplement our comments today. They are posted on the Investor Relations section of Dow's website and through the link to our webcast.

I am Pankaj Gupta, 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 will see our agenda for the call. Jim will begin with the first quarter highlights and will discuss the company's operating segment performance. Howard will provide our modeling guidance and our latest benchmarking performance. And then Jim will close with an update on our plastics circularity road map and market outlook. Following that, we will take your questions.

With that, I will turn the call over to Jim.

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

Thank you, Pankaj, and thanks to everyone for joining us today. Before we begin, I'd like to recognize and thank Colleen Kay, who announced her retirement from Dow after over 31 years of outstanding service, and also to welcome back Pankaj Gupta, who many of you already know.

Starting on Slide 3. Our results for the first quarter once again demonstrated the focus and agility of Team Dow which enabled us to quickly recover from the impact of winter storm Uri on the U.S. Gulf Coast.

This event had a far-reaching impact across our industry and broader market. Our colleagues quickly and safely got our units back online some of which began coming up within a week of the storm. All impacted Dow units are back online, and we reached pre-storm operating rates by the end of March, ahead of plan.

Our team's efforts, combined with improving demand and tight industry supply conditions, drove results higher than the updated guidance we shared last month at the JPMorgan investor conference. At the company level, Dow achieved double-digit growth on the top and bottom lines, both year-over-year and sequentially.

A few highlights in particular: Sales were up 22% year-over-year, with gains in all operating segments and in every region. We continued to benefit from strong price momentum, with improvements in all segments, businesses and regions. Volume was in line with the year ago period as gains in construction, mobility, electronics and consumer durables end markets, as well as higher energy demand, were offset by supply constraints from the storm, and we continue to improve our working capital efficiency with a net improvement of 3 days.

Sales were also up sequentially with growth in all segments and regions. This top line growth and our continued focus on cost discipline led to bottom line growth and our highest EBIT quarter since spin. We achieved more than $700 million of EBIT growth from the year ago period and $500 million sequentially.

We delivered equity earnings improvements of more than $300 million led by Sadara. Earlier this month, Sadara, with help from Dow and Saudi Aramco, worked to bring its mixed feed cracker back online faster than anticipated and downstream production units are also back at expected rates.

We also completed key structural changes to our U.S. defined benefit pension plans in the quarter, which reduced the company's pension liability. Cash flow from operations was more than $750 million, excluding a $1 billion elective pension contribution. And Dow, Saudi Aramco and Sadara completed the joint venture's debt reprofiling, which will provide approximately $350 million cash tailwind to Dow in 2021. Sadara is now expected to be cash flow self-sufficient. In summary, Team Dow remained agile in an extremely dynamic business environment to deliver strong top and bottom line growth, positioning Dow for greater value creation going forward.

Moving to our segment performance on Slide 4. In the Packaging & Specialty Plastics segment, operating EBIT was $1.2 billion, up nearly $650 million versus the same quarter last year and $448 million sequentially. Resilient demand, tight market supply, disciplined price volume management and polyethylene inventory levels at 5-year lows enabled momentum in polyethylene earnings. The Packaging & Specialty Plastics business achieved double-digit sales gains year-over-year and sequentially, driven by local price momentum in all regions. Versus the year ago period, local price gains were led by improvement in industrial and consumer packaging and flexible food and beverage packaging applications.

Moving to the Industrial Intermediates & Infrastructure segment, operating EBIT was $326 million, up $151 million year-over-year due to strong supply and demand fundamentals in polyurethanes and construction chemicals and higher equity earnings led by continued improvement from Sadara. Sequentially, operating EBIT improved $30 million despite significant impact from winter storm Uri.

The Polyurethanes & Construction Chemicals business achieved a double-digit net sales increase compared to the year ago period, led by local price momentum in polyurethanes. Demand growth in consumer durables and appliances and industrial end markets was more than offset by volume limitations on the U.S. Gulf Coast and other third-party supply constraints related to the storm. These pricing and volume dynamics also drove sequential sales growth.

The Industrial Solutions business delivered net sales in line with the year ago period as higher prices in all regions were offset by volume constraints primarily due to winter storm Uri. Improved demand in textiles and electronics applications was more than offset by supply limitations. Net sales were also in line sequentially due to the same drivers.

And finally, the Performance Materials & Coatings segment reported operating EBIT of $62 million, down year-over-year as local price gains across the portfolio and strong demand for architectural coatings and silicones applications were more than offset by the impact of the winter storm as well as planned maintenance. Sequentially, operating EBIT was up $12 million.

The Consumer Solutions business achieved higher net sales year-over-year on local price increases for siloxane and robust demand for consumer, electronics and mobility applications. These gains more than offset the impact from planned maintenance. Sequentially, the business delivered local price gains across all regions and achieved sequential volume gains in all regions except Asia Pacific, where strong gains in performance silicones were more than offset by planned maintenance downtime at our Zhangjiagang siloxanes asset.

The Coatings & Performance Monomers business delivered higher net sales year-over-year, driven by price gains in all regions, notably in acrylic monomers due to strong supply and demand fundamentals. Supply constraints from winter storm Uri and planned maintenance at our Deer Park asset more than offset continued demand strength for architectural coatings. Sequentially, the business achieved price gains, particularly in acrylic monomers due to increases in raw material costs.

I'll now turn it over to Howard to review modeling guidance and the results of our annual benchmarking.

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

Thank you, Jim. Moving to Slide 5, as we turn to the second quarter, market demand remains robust in packaging, electronics, mobility, architectural coatings as well as consumer durable end markets. While sectors like home care have begun to normalize, we do expect additional upside on continuing economic recovery in the industrial sector. And as travel, workplace and social activities resume, they will also provide a boost in demand for higher-margin personal care applications, as well as across the service sectors of the global economy. These constructive market trends will continue to support top and bottom line growth across all Dow operating segments in the second quarter.

We are entering turnaround season in the Northern Hemisphere, and we expect increased spending of approximately $125 million sequentially, particularly in the U.S. Gulf Coast, including a turnaround at one of our crackers in Louisiana. We also expect an additional $100 million from outages, including a third-party supply disruption on the U.S. Gulf Coast.

Collectively, robust demand, tight supply, low inventories and increased raw material costs are providing support for prices across many of our value chains. We expect the constrained industry inventory levels to continue in the second quarter, preventing inventory builds until later this year as we focus on clearing the growing backlog of customer orders.

All combined for the second quarter, we expect approximately $750 million to $800 million in higher earnings versus the prior quarter from a combination of earnings momentum in our key chains and lower sequential costs from winter storm Uri. This earnings growth will be partially offset by approximately $200 million to $250 million in higher costs from turnarounds and the third-party outage I mentioned. Altogether, we expect second quarter to be our strongest performance since spin.

Moving to Slide 6, we're also updating a few key items in our full year modeling guidance. The positive momentum I just mentioned will also benefit our joint ventures, particularly Sadara. We also expect to see slightly higher turnaround spending than previously anticipated as winter storm Uri has put some upward pressure on the cost of materials and labor in the U.S. Gulf Coast.

Finally, our decision to freeze our U.S. pension plan accruals and contribute $1 billion to the U.S. pension plan, along with the subsequent remeasurement, provides an approximately $200 million tailwind to pension expense year-over-year. Overall, for the remainder of the year, we continue to see broad-based economic momentum, recovery from winter Storm Uri and elevated consumer demand.

Moving to Slide 7. Today, we also released our annual benchmarking update, which is available on our investor website and in this earnings presentation. I continue to be very proud of our team's efforts to achieve top quartile results across most of our peer comparison performance metrics.

To summarize our results, at the enterprise level, our focus on cash extended Dow's advantage on EBITDA to cash flow conversion and enabled free cash flow performance above peers, above the industry as well as above the broader market. This supported our continued leading dividend yield and further strengthened our balance sheet even through the pandemic. We also maintained our top quartile cost management and margin performance.

At a segment level, Packaging & Specialty Plastics outperformed the peer median across adjusted operating EBITDA margin, free cash conversion and SG&A and R&D spend. And Dow's operating EBITDA per pound of polyolefins capacity continues to outperform peers, expanding further in 2020.

Both Industrial Intermediates & Infrastructure as well as Performance Materials & Coatings, outperformed the pure median on cash conversion as well as on SG&A and R&D spend. We do see near-term opportunities to improve adjusted operating EBITDA growth by continuing to implement our faster payback, higher ROIC expansions. This includes our ethylene cracker expansion in Canada, our FCDh retrofit, our polyglycols expansion and our downstream silicones expansions as well. And projects like the South China Specialties Hub will enable us to capture higher value polyurethane systems and alkoxylates demand in the fast-growing Asia Pacific market.

Looking ahead, we are well positioned to grow earnings and maintain our track record of cash generation. Our differentiated consumer-led portfolio, with leading positions across most of the markets we serve, enables us to capture growth in our key value chains and ongoing market recovery in automotive and personal care. For example, in the mobility global megatrend alone, electric vehicles use 3 to 4x more Dow silicone products than traditional vehicles.

Together, our strong operational, financial and commercial playbook, supported by the broadening economic recovery, positions Dow well for future earnings and cash flow growth.

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

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

Thank you, Howard. Moving to Slide 8, before discussing the market outlook, I want to reinforce how sustainability continues to be another growth driver for Dow. Last quarter, we shared our road map to achieving our 2030 carbon reduction targets. And this past week, Columbia University and the Nature Conservancy announced our partnership to better account for the role of that materials and sustainable applications play in achieving emissions reduction, including plastics.

Plastics have a lower carbon footprint than traditional materials, and we are leading the way to a circular economy for plastics. Through our "stop the waste" and "close the loop" targets, we're enabling 1 million metric tons of plastics to be collected, reused or recycled by 2030 and targeting 100% of our products sold into packaging applications to be reusable or recyclable by 2035. These targets require innovation and collaboration in mechanical and advanced recycling, as well as in designing for recyclability.

To that end, through collaboration across the value chain with Dallas Pack Studios, we're working to accelerate sustainable packaging solutions, tailor-made for those customers and consumer brand owners, many of which have set targets to incorporate 25% or more post-consumer recycled material in their products. We're helping consumer brands design their packaging to be fully recyclable.

Our collaborations to develop fully formulated recyclable packaging solutions include developments with Kellogg's Kashi Bear Naked Granola, Reckitt Benckiser's Finish Dishwashing Detergent and China's leading laundry brand, Liby. Each enable a larger addressable market and sales of higher value Dow materials. We sell products containing mechanically recycled materials in every geography, and now we're beginning to scale a family of products that can be used in either flexible or rigid packaging applications.

Dow is also developing advanced recycling technologies that convert used plastics into their feedstocks. We continue to scale up these capabilities with our partner, Fuenix Ecogy Group. And today, we announced a partnership with Mura Technology, to convert plastics back into the oils and chemicals from which they were made for use in new virgin equivalent plastic products. This revolutionary advanced recycling technology can convert all forms of plastic into feedstock, including many considered to be unrecyclable.

We're also actively engaged as a founder of the Alliance to End Plastic Waste and with key stakeholders around the world to help solve critical challenges to plastics recycling. For example, through our collaboration with Circulate Capital, Dow is bringing material science capabilities to Lucro Plastecycle and Marico Limited, one of India's leading consumer brands, to enable sustainable, flexible film packaging with recycled content.

Our actions to advance plastic circularity are value-accretive to Dow. And our differentiated product slate, downstream knowledge, intimacy with consumer brands and strategic partnerships give us a leading-edge to capture this growth.

Turning to Slide 9. As Howard mentioned, Dow remains well positioned to benefit from improving industry and market conditions. We see several positive leading indicators, including momentum and job growth, consumer spending, a return to air travel and expanding manufacturing and industrial activity for global manufacturing PMIs at a 15-year high in March. These trends are further supported by government stimulus measures and accelerating vaccine rollouts globally.

The spending elements of the U.S. infrastructure plan, if passed, will further support growth in our downstream markets. Similarly, incentives aligned to more sustainable energy solutions should be beneficial to our business and to attaining our own sustainability targets. These programs are not currently included in our assumptions, but could drive additional growth if enacted in a manner that supports manufacturing competitiveness.

These macro trends translate into a 1 to 2x GDP growth across key end markets, including packaging, infrastructure, mobility, consumer durables and industrials and home and personal care. Given this backdrop, we see demand in our key value chains continuing to outpace supply throughout 2021 and staying balanced in the near-term across ethylene, polyethylene, polyurethanes, acrylics and silicones chains.

Some industry views call for softening conditions in the near term, largely based on their view of planned capacity additions. However, these views do not account for industry project delays or cancellations nor do they account for the maintenance activity or reliability impact from weather-related events like the winter storm.

Industry delays and cancellations of planned capacity additions, along with elevated demand growth as the global economy continues to reopen will likely lead to tighter than predicted market conditions, all of which will result in continued earnings, margin and cash flow growth for our core businesses and joint ventures in the near term. And while we capture these improved earnings over the next several years in our core businesses, our current slate of lower capital, faster payback and higher return capacity expansions will add nearly $1 billion of accretive earnings to our bottom line.

Dow's points of distinction continue to raise our earnings and cash flow potential relative to peers. The market growth we expect in our business, combined with our industry-leading feedstock flexibility, global scale and advantaged cost positions, our top quartile cash generation and our innovation and leadership in high-growth end markets enable Dow to continue to deliver value for our owners through 2021 and over the foreseeable future.

With that, I'll turn it back to Pankaj to open the Q&A.

Pankaj Gupta

Thank you, Jim. Now 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 instructions.

QUESTIONS AND ANSWERS

Operator

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

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

Jim and Howard, in plastics, how are you thinking about sequential earnings improvement here? Given the price margin growth we're seeing, can you get to $2 billion of EBITDA in Q2? Is that possible?

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

David, as you noted, obviously, we continue to see strong demand growth in plastics. And if you look at our sales, we're looking at 3% to 7% higher sales in the quarter. And obviously, operating rates should be much improved given that we won't have the impact of winter storm Uri. We do have some turnarounds, as Howard mentioned. So we have a Louisiana cracker that's down. But having said that, it looks like [demand is going to be greater than supply] (corrected by company after the call) for the foreseeable future. I don't anticipate we'll be looking at any kind of an inventory build until probably the fourth quarter. And so with that, kind of a year that feels like 13 months of demand and 11 months of supply, and it looks like raw material costs are going to continue to remain low.

Operator

And next, we'll move to Bob Koort with Goldman Sachs.

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

I appreciate the benchmarking information. It was helpful. I'm curious, you've showed already a pretty considerable cash flow yield and that's before the ramp in earnings. I think you've outlined a couple of projects, handful there that would get you maybe an incremental $1 billion of EBITDA. Can you give us a sense of the cost and cadence of that incremental earnings growth? And then how are you going to deploy all the excess cash given those industry outlook slides -- curves on Page 9 look pretty darn good for quite a while. So are you going to change your capital deployment strategy here? What are your plans there?

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

Yes, thanks, Bob, for the question, and a lot in that question. And I feel good, given that we had about a $400 million impact from winter storm Uri in the quarter, we delivered $750 million of cash from operations. Obviously, we took an elective pension contribution in the quarter, but our cash flow generation continues to remain strong.

We stepped up CapEx this year to a little over $1.6 billion to get our growth CapEx coming back up. And all of that is on faster payback types of projects. So for example, we started up a polyethylene glycol facility in the first quarter down in the Gulf Coast, which will be accretive this year. We also just brought on another furnace in Fort Saskatchewan. The furnace part is active. So about half of the benefits of that start now, and we'll do some work on the back end of the cracker toward the end of the year and bring on the other half of that capacity. So if you think about the incremental projects that we have to deliver that $1 billion, I feel like we can be increasing capital towards depreciation and still be able to deliver that $1 billion of EBITDA growth.

And then obviously, we want to continue to support the dividend. And if you think about our capital allocation priorities, they are in order: safely and reliably operate the plants, continue to support that industry leading dividend, the growth CapEx, I mentioned, some incremental gross deleveraging. So we've got another $1 billion of targeted gross deleveraging to get our net debt-to-EBITDA ratios where we targeted them. And then share buyback to cover dilution. And right now, that's where we'll stop on share buyback.

Anything you want to add, Howard?

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

You covered it.

Operator

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

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

Are you satisfied with your returns in Performance Materials & Coatings? And what does that segment need to do to raise its operating output? And secondly, on pension expense, you talked about a $200 million pension tailwind. What exactly is your pension expense roughly in 2021?

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

Yes, let me take Performance Materials & Coatings, and I'll have Howard talk about the pension expense. Both businesses in Performance Materials & Coatings, had some downtime and some maintenance costs in the first quarter. So I think when you're looking at first quarter results, that isn't reflective of the market demand in the marketplace. We had the siloxanes plant in China down, and we had the Deer Park facility down for maintenance. And then, of course, the winter storm really lengthened that maintenance.

The demand for both of the products is improving and the pricing for siloxanes, which has been one of the bigger drags on consumer solutions, is starting to move in the right direction. And a lot of that is because automotive demand is coming back and construction is coming back. And we have yet to see Personal care, which I think is going to come back through the year.

And on top of coatings and monomers, monomers were strong in the quarter. Architectural coatings and specialty do-it-yourself continues to be strong. Industrial is starting to show improvement as automotive comes back. And of course, as air travel begins, we'll start to see a big part of industrial come back as well.

Howard, on pension?

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

Yes, Jeff, pension expense, when you look at pension and OPEB, it's around $100 million is our expected expense this year, which is going to be down a couple of hundred million dollars as we talked about in the prepared remarks.

Operator

Next, we'll move to P.J. Juvekar with Citi.

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

A couple of quick questions on polyethylene. The peak like margins that the industry is seeing today in that $0.40, $0.50 range per pound, if that remains elevated, could you see incentive to add more supply, particularly in China? And then just on -- sticking to polyethylene. Jim, you guys have done a great job on circular economy and Alliance to End Plastic Waste. On bioplastics, there are these small companies coming up. You had that PLA technology down in Brazil. Does that still exist within Dow now? I know that was shut down. And can you revive that if the demand takes off in biopolyethylene?

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

P.J., the margins in polyethylene, I think, are reflective of a couple of things: improved spreads in ethylene, and that obviously has been driven by the fact that ethane costs remain low, natural gas costs remain low, and oil has recovered from kind of an unreal scenario a year ago today. And that's raised, obviously, the naphtha pricing and that's raised the floor around the world.

The other thing that's happened though is we had growth in plastics and packaging, even through COVID. And so most people were expecting businesses to be down during that time. And I think they underestimated how much growth is there. We're seeing growth over 2020 in plastics. We would have seen in the first quarter without the winter storm. And so we're going to see that continue to grow. So I think we've got continued outlook for high earnings through the year on plastics.

On bioplastics, we're doing some work right now on biomaterials to make plastics, really looking at wood byproduct derivatives that we can use to blend in with naphtha. We're doing some work with Fuenix Ecogy Group to bring recycled materials back in.

One of the challenges with bioplastics is not so much the degradability that everybody in the market likes, but it's their thermal stability in terms of being able to form them and do what you need to do with them, and then have them have the kind of durability you need for food packaging. But we're open to collaborations in those areas, and we're always looking for new things that we can do in that space.

Operator

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

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

And good to hear your voice again, Pankaj. As I look at these results, pretty impressive results, and you had 14% price improvement in the first quarter versus the fourth quarter. How does April stand relative to the first quarter? And just more generally, what's your expectations on price throughout 2021?

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

Frank, we've got $0.09 up for April and another $0.05 up for May in the U.S., and the April order book is very solid. So I think that's a strong, strong probability. Look, in most of our businesses, beyond even plastics, the order book for the first quarter is very solid. A combination of some backlog that got created from the winter storm and just the normal demand by the year-over-year improvements we see in construction, we see in automotive, we see consumer durables, we see in electronics. So my feeling is that it's constructive for the year and our outlook for raw materials costs are going to continue to remain low throughout the year.

Operator

And Steve Byrne with Bank of America will have our next question.

Steve Byrne ***BofA Securities, Research Division - Director of Equity Research***

Yes. Jim, you made a few remarks earlier about outages, you've got turnarounds, you've got new supply coming, a lot of moving parts in industry operating rates. And I just wanted to ask you to put that into perspective on your -- on the Slide 9 that has your multiyear outlook on industry operating rates for polyethylene, MDI and siloxane. How would you compare those forecasts to current industry operating rates?

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

Yes, Steve. It's a good question because I think most of the third-party views out there are kind of taking the worst-case scenario. And so that would be the bottom end of what we think the ranges of operating rates are. We're going to be in the 90s in both ethylene and polyethylene for the quarter, unless there's some unplanned event. And as we sit here today, there's probably about 15% of that capacity off-line, which is well in excess of what we normally have. We normally have probably 6% to 8% off-line.

Same is true for polyurethanes and isocyanates. You see the downstream demand pull is very strong. And siloxanes pricing improvements is all driven by downstream demand improvements. So my sense is that we're going to be in strong operating rate territory for the entire year. I don't think we'll be building inventory until maybe possibly the end of fourth quarter, which -- and that all depends on whether we have a slow fourth quarter or not. But there's upside in automotive, there's upside in travel, there's upside in construction and home, there's backlog in appliances and long lead times. Everything is pointing in the direction of high operating rates.

Operator

And next, we'll hear from Hassan Ahmed with Alembic Global.

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

I wanted to sort of quickly ask you about the sequential guidance you guys gave. If I heard Howard correctly, it sounds as if he's talking about a sort of between the positives and negatives, around a $600 million uptick sequentially. So call it $2.8 billion, $2.9 billion in Q2 EBITDA. So my question is that if that is the guidance, what sort of pricing is being baked into that guidance? Meaning, obviously, you guys talked about a round of April price hikes. There seems to be another round of price hikes on the table for May. So that guidance that you are giving, is it capturing both April and May price hikes, meaningful realization of those hikes?

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

Yes, if you look at IHS forward view on pricing, they've got about $0.12 a pound quarter-over-quarter for the United States. And in Europe, they've actually got a reduction, a slight reduction, and Pacific, they've got a slight reduction.

My sense is that the U.S. margins are going to see that and I think we're going to continue to see demand strong in China. We've seen a good rebound there. And then in Europe, we've seen good demand. It hasn't been as strong as the rest of the world. Obviously, the virus, it's had a little bit more impact. And Latin America has been similarly hit a little bit hard with the virus. But I think as the quarter progresses, I think we have the potential to see that firm up a little bit.

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

And, Hassan, this is Howard. The only thing I would add is your math that you articulated in your question is spot on.

Operator

And John Roberts with UBS will have our next question.

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

Could you talk a little bit about the Sadara restructuring? I think Dow's exports from Sadara was a key part of Dow's Asia growth strategy. So do you need something else now to backfill as you lose a little access here to some of the Sadara output?

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

Yes, I'm going to ask Howard to talk about that because he and the team did a lot of heavy lifting to get that done. But on the growth side, that's where we'll be looking at some incremental investments, including on the ground in China for specialty hub to be able to convert differentiated PU and alkoxylates for high growth in Asia Pacific. And we're also looking at incremental expansions that we could make in the U.S. to be able to supply more material over there. Howard?

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

Yes, John. Yes, the Sadara reprofiling is done. As you know, it was -- it took us about 2 years to get it all done, but we got it done within the timeframe that we committed to. The maturity date is now extended out to 2038. There was no upfront or prepayment of any of the outstanding debt. There's a grace period until June of 2026 on any principle, and the guarantees were significantly reduced.

When you look at Sadara's operating performance, it really was a standout. I mean, all of our joint ventures did well in line with our core earnings growth that we reported. But when you look at the 3 joint ventures, Sadara actually had the best earnings growth, both year-on-year as well as sequentially. And if they keep up this pace, they likely will be paying off some additional principal still this year, which was not expected when we did the reprofiling. So really strong performance from Sadara.

Operator

And next, I'll move to Laurence Alexander with Jefferies.

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

On the plans that you sketched out for advanced recycling, can you -- do you have initial thoughts on likely capital intensity or where they'll fit on the cost curve? Would it be competitive of naphtha?

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

Yes, Laurence, and thanks for the question. This is one of the things I think that everybody is trying to wrestle with, and it's a very local issue because it gets into a variety of moving parts, including what's the cost to landfill materials. I would say that the demand pull is there from the brand owners and from the marketplace for more recycled content, and that's what's driving the investments.

To date, most of the investments have been around mechanical recycling because it's very low cost, and it's also low energy intensity. And so the growth in those applications is great. But there's a limit to what that can do. So when you get into flexible packaging and a few other areas, you need advanced recycling. And there you get into technologies like pyrolysis and gasification to make that happen. And that's a little bit more expensive.

So as we move forward, I would think we're going to need to see a market-related price on carbon, which has been discussed in the EU and is also going to start being discussed here in the United States to help create that gap and that value that will drive that return. And it's a little bit early to get into huge capital numbers or return numbers.

What we're doing today is piloting different technologies, trying to prove out business models that work. And then once we see what works and we can replicate it, we'll come back and we'll talk more about what the investment looks like.

Operator

And Vincent Andrews with Morgan Stanley will have our next question.

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

Just a quick housekeeping for Howard. What is the unfunded pension liability post the $1 billion contribution? And then maybe, Jim, just a follow-up on the prior discussion, you put this press release out by the partnership between yourselves and Mura on a new game-changing advanced recycling solution. I've just been eyeballing it, and I can't tell if you're making a financial contribution or if you're just taking the offtake and sort of what you think the time frame and scalability of it is, but maybe you could give us just a little bit more discussion of this new partnership.

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

Vince, this is Howard. So our underfunded status on the pension plan at the end of the quarter was $6.4 billion, and that was a decrease or an improvement of $2.3 billion versus year-end 2020, which is a combination of the voluntary contribution plus the remeasurement that we took at the end of the quarter.

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

Yes, and on Mura, it's really taking advantage of their technology to use all forms of plastic waste, some of which I mentioned are unrecyclable today. So we will make an investment, it's not a material investment in terms of dollars to help scale the technology, but we'll also increase the amount of advanced recycled material as feedstock for our own assets. The pilot facility is going to be in the U.K. and it's a hydrothermal plastic recycling solution that is developed by Mura. And we'll continue to work with them to prove that out. And to help develop products that will perform in the marketplace to drive growth in that sector.

Operator

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

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

I guess, maybe 2 quick ones. Just on the equity line, it looks like you're guiding to $400 million to $500 million for the year, yet you just did just about [2.25] in the first quarter. Is there some seasonality or some onetime thing that we should be thinking about in that?

And then just on the inventory side, I think you mentioned specialty or packaging, specialty plastics is going to be really tight through -- into the fourth quarter. I guess, can you give us some color as to what you're seeing in the performance mats and coatings area and the II&I area, if it's equally as tight on the inventory front? Or if there's a little bit more cushion there and maybe can be made up quicker?

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

I think on -- when you get into polyurethanes and II&I, polyols is very tight right now, and I expect that to continue to be the case. And isocyanates will have good operating rates through the year as this demand in construction and also automotive continues to grow.

If you looked at coatings, I expect monomers to be tight through the year given the improvements in downstream coatings. And obviously, architectural has been strong. If we see a boost up in the do-it-yourself or the contract side of coatings market, then we could see another leg up and some more tightness in that sector.

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

Yes. And I would just say on, John, on the equity earnings line, your math is right. There is some seasonality to think about MEG out of EQUATE, but also there is higher turnaround expenses. So you've got the higher turnaround expenses in Sadara this year, as well as Thailand, as well as EQUATE, so you've got to subtract that extra $100-plus million from the turnaround as well.

Operator

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

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

If I look at your second quarter guide, it seems to imply for the first half that you would earn somewhere north of $5 billion in EBITDA and annualized that, of course, would be more than $10 billion. How would you compare and contrast that sort of level versus your view of Dow's future peak earnings power when you take into account your price margin outlook, the organic investments that you talked about and other sources of growth?

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

Thanks, Kevin. And I think normally, when we go into the year, second quarter and third quarter tend to be our peak quarters. Obviously, things tighten up in first quarter, and so we saw a really strong first quarter result as well. So my sense is we had gone into this year, trying to get back to mid-cycle earnings. I think we're ahead of that in some sectors and we'll be that way. And with our spending on really these fast payback projects, some of them which have payback less than 3 years. I think that has the ability to move the top side up.

Howard, do you want to comment on the range, on what peak earnings could look like?

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

Yes. Kevin, look, when we came out at spin, we were looking at the capital structure and that whole discussion. We talked about trough earnings around $6 billion. Last year, it was $5.6 million. So we were definitely in a trough. We got there because of the pandemic more than anything else. And peak earnings with the portfolio at spin was between $12 billion and $13 billion. And now we continue to add additional incremental growth projects from there. So you pick a number, but we still have a significant amount of upside as you head into, hopefully, a continued economic up cycle from here, even with that first half annualized that you talk about.

Operator

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

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

Congrats on the strong results here. I guess, similar question. When you think about the segments here, first off with PM&C, obviously, continues to struggle. What is it really going to take to get that business back to normal? Is it just a resumption of personal care and mobility as you discussed earlier? And then similarly, with II&I, we've seen a pretty strong move in MDI, especially in China and in Asia earlier. Do you expect that to kind of come over to North America and Europe in the coming months?

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

Arun, look, I just want to go back to the first quarter comment on PM&C. So I don't think the first quarter is reflective of the market for PM&C. And I don't think the business continues to struggle. Downstream silicon, the high-margin part of silicones downstream got hit pretty hard during COVID, obviously, personal care applications. But also we saw construction down really last year, and it's starting to come back. So right now, you're starting to see strength in siloxane, you're starting to see strength in construction. Mostly it's been residential construction, but it's moving back into high rise buildings. Again, consumer electronics is driving it. industrial manufacturing is driving it, and mobility, as Howard mentioned.

EVs is really positive for us on a Dow overall standpoint. We get about twice -- 50% more content on an EV than an internal combustion engine. On a silicon standpoint, we've got about 3 to 4x more than an internal combustion engine. So we're seeing surges there.

So I think you're going to see PM&C improve as the year goes through. And obviously, we'd have had a much better quarter without the Deer Park downtime and the extension of that due to the winter storm Uri. So I would say, let's look at PM&C as the year progresses. I think you're going to see a good story coming out of that business.

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

The other point on PM&C is really the Zhangjiagang asset. So we have 3 big pillar plants that produce siloxanes around the world, one in the U.S., one in Europe and one in China. And the one in China was out for a big chunk of the first quarter. So obviously, we were unable to produce, and we had all that fixed cost that was -- that went unabsorbed that dropped to the bottom line as a negative impact, as you saw.

Operator

And next, we'll hear from Alex Yefremov with KeyBanc.

Aleksey V. Yefremov ***KeyBanc Capital Markets Inc., Research Division - Research Analyst***

Jim, you just mentioned capital costs could start trending towards depreciation. Just to clarify, do you mean D&A that I think you're guiding to about $2.9 billion or just the depreciation part of it? And also, how quickly do you think you'll get there? Is it something we should consider for next year already or over the next 2, 3 years, perhaps?

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

Yes, good question. And I think we'll ramp into it. A lot depends on what we see in downstream demand. And if we continue to see these downstream demand pools, we're going to have to ramp into that post this year.

We've also got to look at investments that we've been talking about on sustainability as well. Our depreciation level is about $2.2 billion. And so I think our first ramp would be to that level. And then we have discussions here and with our investors as we get opportunities to go beyond that. And obviously, you have to look at the value creation of that.

Operator

And we'll move on to Mike Sison with Wells Fargo.

Michael Joseph Sison ***Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Analyst***

Nice quarter and outlook. In terms of the $1 billion of earnings you talked about on Slide 9, how much of that can hit in '22? And I know it's a little bit early, but given some of these incremental investments, and your outlook relative to the industry consultants, should EBITDA in '22 continue to grow from '21?

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

Yes, I think when it comes to additional capacity, I think the answer to that is yes. I think the demand is going to continue to grow. Obviously, you can see the leverage that we have to the upside on margins. So I'll leave that -- what the margin spread for '22 looks like out of the equation. But we probably got $100 million, maybe $150 million of additional accretive earnings based on these new incremental expansions in '22.

And these things that I mentioned earlier, polyethylene glycols came online in first quarter, just about a month ago. And the furnace at the Fort is up and has half of its rate already, and it will get the other half of its rate at the end of the year. And then we've got some other alkoxylation investments that will come on next year in II&I. We've got some investments in, obviously, silicones. Last year, we did more than 15 incremental investments. This year, we've got another 15 for high-margin downstream silicones materials. And so those will come on. And then we've got miscellaneous debottlenecking going on everywhere to try to get incremental growth out.

Operator

And we'll move on to Duffy Fischer with Barclays.

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

Two kind of house-cleaning questions. First, as the Sadara marketing agreement winds down to the new terms, how visible will that be in your P&L and cash flow? And then on the pension voluntary, how did you think about the return on that $1 billion? And should we expect more voluntary cash to go into the pension over the next several years?

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

My expectation on the PMLA changes, Duffy, will be that you'll see that gradual over time. I think it will take a number of years for our marketing to reflect our equity stake and obviously, for the Aramco side to do the same. So it won't happen overnight, I think it will happen over time. And I think you'll see it more on the revenue side than you will on the earnings side.

Any other thoughts about that, Howard?

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

Yes. If anything, Duffy, I would say you should see our unit margins improve. Because right now, we're marketing 90-plus percent of the Sadara volume, but we obviously only own 35% of the equity. So that really -- and we get a very -- we only get a very, very small marketing fee on those volumes. So as that shifts more to our equity ownership in the JV, our unit margin should actually increase just because of that dilution.

And remind me what your pension -- what was the specific pension question?

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

Do you think you will put more voluntary cash into the pension over the next 2, 3, 4 years?

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

Yes, so I mean, look, with the pension smoothing that went in with the last bill, we don't have really any mandatory pension payments that we need to put in, in the U.S. plans for the next several years. So that was about -- it's probably about a $300 million to $400 million savings. From a voluntary standpoint, look, I am a believer that interest rates will move up over time. And so it doesn't take much from an interest rate perspective and maybe 1 year of additional [ERLA] to really get that plan close to fully funded.

So with that said, we'll be opportunistic. And if it makes sense economically, I mean, that $1 billion voluntary pension payment was a very good economic decision for the company. And so we'll continue to look at that year-by-year from an economic perspective. And if it's value creating, we might do it, but we'll compare that to the other capital allocation priorities that Jim laid out earlier on the call.

Operator

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

Pankaj Gupta

Thank you. Thank you for everyone, thank you to 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 within 24 hours. This concludes our call. Thank you very much.

Operator

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

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