Dow Chemical targets narrower scope, higher returns

Robert Westervelt

Dow Chemical management set out near-term growth and shareholder return expectations at an investor meeting in New York 7 November, stating that a narrower scope and improved operating discipline would deliver higher returns and lower-risk growth. Near-term cost reduction and incremental expansions can deliver an additional $2–3 billion in EBITDA over the next five years, said company officials. The company generated EBITDA of $9.2 billion earned in the 12-month period ended 30 June.

"We've been through a substantial change since we merged Dow with DuPont and created three divisions," Dow Chemical CEO-elect Jim Fitterling said at a press briefing before the meeting. "The scope [for the new Dow] is more focused and streamlined, and we'll show how that translates into higher shareholder remuneration and better total shareholder return." DowDuPont will spin off Dow to shareholders on 1 April 2019.

Dow has cut focus sectors down to 3—packaging, infrastructure, and consumer care—from more than 10 before the merger. The company will "right size" its cost base following the shift of its more resource intensive agricultural operations to Corteva and roughly $4 billion in former Dow specialty assets to DuPont. New Dow will target administrative costs of less than 1% of revenue, down from around 2% under historical Dow. Organizational layers below the CEO level have been cut from as many as eight to no more than six, Fitterling said. The number of positions within the top three

FITTERLING: Targeting $2–3 billion EBITDA boost.

layers of management have been cut 25–3(Fitterling added.

The company will hold near-term capita expenditures around $2.8 billion/year, a le below depreciation and amortization, dow from roughly $4 billion/year between 201 and 2016, which included massive investments for a US Gulf Coast cracker and derivatives as well as its Sadara joint ventu with Aramco in Saudi Arabia. Both project offer significant low-capital cost incremen expansion opportunities over the next fev years, Fitterling added. The company will target an operating return of greater than on invested capital.

A second wave of brownfield expansion the packaging and specialty polymer segm will boost polyethylene (PE) capacity by a further 1.4 million metric tons/year by 20 and include an expansion at its new Freep Texas cracker with potential to generate additional EBITDA of $600 million–1.1 billion/year. Investments in silicones, polyurethane systems, and ethylene oxide derivatives will deliver additional EBITDA $200 million–400 million/year. Remainin cost savings will generate $1.2 billion in annualized EBITDA, Dow said.

Dow also plans to return significant casl shareholders. Roughly 65% of net income across the cycle will be dedicated to divide and share repurchase, according to Dow president and CFO Howard Ungerleider. A least 20% of net income would be targeted share repurchase combined with a dividen payout across the cycle of 45% of net inco

"We have established a capital structure balance sheet for the new Dow that will se as a strong foundation to continue our profitable growth and increase shareholder returns," Ungerleider said. "We have the strategy, portfolio, management team, and mindset in place to capitalize on the signifi cant earnings and cash flow upside opportu ties in front us."

Megadeals continue to dominate chemical M&A

Robert Westervelt

Global merger and acquisition values remain elevated because of megadeals, but deal activity is slowing, according to an industry banker.

In the first three quarters of 2018, $89.6 billion worth of chemical industry deals were announced, says Peter Young, president of Young and Partners (New York). Just two deals, Monsanto-Bayer and PotashCorp-Agrium, represented 78% of the total. Activity in the year-ago period was likewise dominated by megadeals: $149 billion worth of transactions closed in first three quarters of 2017, dominated by three deals: Dow-DuPont, ChemChina-Syngenta, and Sherwin-Williams-Valspar.

Deal volumes have slowed with 42 deals completed in the first three quarters of 2018 compared with 67 in year-ago period. "Overall, the volume of deals has been healthy, but we have a dwindling number and dollar volume of deals if you do not account the small number of megadeals and very high dollar volumes if you do," Young says. Megadeals have also been largely concentrated in coatings, industrial gases, and agricultural chemicals and fertilizers, Young adds.

Activity has shifted from Europe and Americas with Asia/rest-of-world accounting 46.7% of deals completed through the first three quarters of 2018, Young says. "[Asia] dominance has been true for quite a few years and has been increasing." Private equity continues to lag historical trends in chemicals representing only 9.5% of the number of acquisitions and 1.5% of the dollar volume, Young adds.

Megadeals will also inflate fourth-quarter results will the October close of Praxair/Linde and Carlyle's acquisition of Akzonobel specialty chemicals business.

Commodity chemical deals and valuations have strengthened a bit. "We're seeing some firming of the commodity chemical multiples and volume is also coming up," Young says. "In specialties, volume is starting to come down and we've only seen a very, very small change in valuations."