Dow Chemical (DOW)
Merger On Track. Ag Pipeline To Add $1.6bn Sales By 2020

Key Takeaway
Dow Chemical recently reiterated that its merger with DuPont (DD, Hold) remains on track for a fall close, with more than $3bn in synergies. A rival spoiler bid still seems unlikely, in our view, but with end markets mixed (ag near trough, polyolefins mixed in 2H?), the stocks should remain range bound. Outperformance likely hinges more on personalities and management appointments.

Merger timing unchanged: Dow recently reiterated that its merger with DuPont remains on track for a close in early fall 2015, followed by a split into three separate companies over the ensuing 18-24 months. The benefits of the merger hinge on Dow-DuPont achieving $3bn in cost synergies (including $600-$800m in purchasing synergies on a combined $42bn procurement spend), with both companies expecting to over deliver. Restructuring costs continue to be pegged at $3.5bn-$4bn. Early indications suggest that while smaller asset sales may be needed to comply with regulatory requirements, larger business disposals remain less likely.

Ag caution offset by new product pipeline: Dow expects the ag market to contract 3%-5% this year, with crop chemical pricing up modestly and pressure on seed prices (echoing peers). Dow’s near-term (2015-2022) agrichemical pipeline targets >$1.4bn in peak sales, adding $100m a year in 2016-2018 and $200-$300m a year in 2019-2020. In seeds, Dow still targets ~100m acres for Enlist, and expects the new seed pipeline to contribute ~$25m in sales growth in 2017, ~$100m in 2018, ~$250m in 2019, and $400-$450m in 2020. Underscoring competitive dynamics, Dow’s precision agronomy service is explicitly “no fee”, not just heavily discounted.

Other considerations: 1/ The Kuwait and Hemlock JVs could be monetized or (in the case of Hemlock) consolidated by 2020; 2/ Near-term, demand remains solid in transportation, construction and general plastics end-markets, with the recent rapid oil rebound helping polyolefin margins in Q2; 3/ US Gulf Coast ethane supply/demand balances by 2021, shifting the focus to propane.

Valuation/Risks
Our $54 price target reflects a range of valuation methodologies (e.g., DCF, DDM, full-cycle earnings, SOTP, etc.) and implies Dow trades at 16x post-deal EPS. Key risks include: softening demand; a tighter ethane-naphtha spread; M&A risks; or mis-allocation of capital.

Financial Summary
Book Value (MM): $25,374.0
Book Value/Share: $22.02
Net Debt (MM): $8,633.0
Net Debt/Capital: 20.3%
Long-Term Debt (MM): $16,215.0
LTD/Cap: 38.1%
Dividend Yield: 4.1%
Cash & ST Invest. (MM): $8,577.0

Market Data
52 Week Range: $57.10 - $35.11
Total Entrs. Value (MM): $65,852.0
Market Cap. (MM): $57,219.0
Insider Ownership: 0.2%
Institutional Ownership: 71.0%
Shares Out. (MM): 1,149.9
Float (MM): 1,112.3
Avg. Daily Vol.: 11,383,348

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Price Performance
## Exhibit 1: Dow Annual Income Statement ($m) Prior To DuPont Merger

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
<th>% Change</th>
<th>Cost of Goods</th>
<th>% Change</th>
<th>Gross Profit</th>
<th>% Change</th>
<th>Selling, General &amp; Administrative</th>
<th>% Change</th>
<th>Research &amp; Development</th>
<th>% Change</th>
<th>Amortization of Intangibles</th>
<th>% Change</th>
<th>Equity in earnings of nonconsol. affil.</th>
<th>% Change</th>
<th>Sundry Income (Expense)</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>44,921</td>
<td>(67%)</td>
<td>(38,932)</td>
<td>(22%)</td>
<td>5,989</td>
<td>(6%)</td>
<td>(2,462)</td>
<td>(25%)</td>
<td>(1,492)</td>
<td>(24%)</td>
<td>(399)</td>
<td>(3%)</td>
<td>630</td>
<td>(5%)</td>
<td>245</td>
<td>15.6%</td>
</tr>
<tr>
<td>2010</td>
<td>53,674</td>
<td>232%</td>
<td>(45,780)</td>
<td>19%</td>
<td>7,894</td>
<td>7%</td>
<td>(2,609)</td>
<td>6%</td>
<td>(1,660)</td>
<td>8%</td>
<td>(509)</td>
<td>8%</td>
<td>1,112</td>
<td>(9%)</td>
<td>332</td>
<td>35.5%</td>
</tr>
<tr>
<td>2011</td>
<td>59,985</td>
<td>29%</td>
<td>(50,892)</td>
<td>12%</td>
<td>9,093</td>
<td>0%</td>
<td>(2,788)</td>
<td>7%</td>
<td>(1,708)</td>
<td>2%</td>
<td>(478)</td>
<td>4%</td>
<td>698</td>
<td>2%</td>
<td>208</td>
<td>-37.3%</td>
</tr>
<tr>
<td>2012</td>
<td>56,786</td>
<td>(25%)</td>
<td>(47,791)</td>
<td>5%</td>
<td>8,995</td>
<td>6%</td>
<td>(2,840)</td>
<td>4%</td>
<td>(1,745)</td>
<td>6%</td>
<td>(458)</td>
<td>2%</td>
<td>1,044</td>
<td>4%</td>
<td>155</td>
<td>-57.8%</td>
</tr>
<tr>
<td>2013</td>
<td>57,080</td>
<td>30%</td>
<td>(47,373)</td>
<td>1%</td>
<td>9,707</td>
<td>6%</td>
<td>(3,022)</td>
<td>2%</td>
<td>(1,647)</td>
<td>(3%)</td>
<td>(436)</td>
<td>3%</td>
<td>835</td>
<td>6%</td>
<td>155</td>
<td>-98.1%</td>
</tr>
<tr>
<td>2014</td>
<td>58,167</td>
<td>25%</td>
<td>(47,226)</td>
<td>0%</td>
<td>10,941</td>
<td>0%</td>
<td>(3,106)</td>
<td>0%</td>
<td>(1,598)</td>
<td>0%</td>
<td>(419)</td>
<td>0%</td>
<td>694</td>
<td>4%</td>
<td>65</td>
<td>73%</td>
</tr>
<tr>
<td>2015</td>
<td>48,778</td>
<td>(0%)</td>
<td>(37,830)</td>
<td>0%</td>
<td>10,419</td>
<td>0%</td>
<td>(2,961)</td>
<td>0%</td>
<td>(1,330)</td>
<td>0%</td>
<td>(419)</td>
<td>0%</td>
<td>694</td>
<td>4%</td>
<td>100</td>
<td>64%</td>
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<tr>
<td>2016E</td>
<td>42,894</td>
<td>17%</td>
<td>(32,475)</td>
<td>3%</td>
<td>10,777</td>
<td>3%</td>
<td>(2,900)</td>
<td>2%</td>
<td>(1,337)</td>
<td>2%</td>
<td>(419)</td>
<td>2%</td>
<td>1,158</td>
<td>0%</td>
<td>100</td>
<td>78%</td>
</tr>
<tr>
<td>2017E</td>
<td>44,550</td>
<td>13%</td>
<td>(33,773)</td>
<td>2%</td>
<td>10,419</td>
<td>2%</td>
<td>(3,000)</td>
<td>2%</td>
<td>(1,337)</td>
<td>2%</td>
<td>(419)</td>
<td>2%</td>
<td>1,158</td>
<td>0%</td>
<td>100</td>
<td>78%</td>
</tr>
<tr>
<td>2018E</td>
<td>46,400</td>
<td>12%</td>
<td>(35,450)</td>
<td>0%</td>
<td>10,777</td>
<td>0%</td>
<td>(2,413)</td>
<td>0%</td>
<td>(1,337)</td>
<td>0%</td>
<td>(419)</td>
<td>0%</td>
<td>1,158</td>
<td>0%</td>
<td>100</td>
<td>78%</td>
</tr>
</tbody>
</table>

% Change:
- Sales: (67%) to 232%
- Cost of Goods: (22%) to 6%
- Gross Profit: (6%) to 7%
- Selling, General & Administrative: (25%) to 6%
- Research & Development: (24%) to 8%
- Amortization of Intangibles: (333.7%) to 33%
- Equity in earnings of nonconsol. affil.: (59.3%) to 46%
- Interest Expense: (142%) to 6%
- Operating Profit: (25%) to 13%
- Pretax Income: (11%) to 9%
- Taxes: (11%) to 15%
- Preferred Stock Dividends: (28%) to 0%
- Net Income avail. for Common Stockholders: (14%) to 9%
- Basic EPS: (67%) to 13%

Net Margin: 4.2% to 6.8%
Taxes: 11% to 15%
Taxes Rate: 1.1% to 25.2%
Prefered Stock Dividends: (34%) to (628)

Source: Jefferies estimates, company data
Company Description
The Midland, Michigan-based Dow Chemical Company is a global manufacturer and supplier of products which are mainly used as raw materials in the production of, but not limited to, products in the automotive, agricultural, construction, chemical processing, electronics, oil and gas, packaging, paints, coatings and adhesives, personal care, pharmaceutical, pulp and paper, textile carpet and water treatment industries. The Dow Chemical Company was founded in 1897 and incorporated in 1947.

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Legend:

I: Initiating Coverage
D: Dropped Coverage
B: Buy
H: Hold
UP: Underperform

**Distribution of Ratings**

<table>
<thead>
<tr>
<th>Rating</th>
<th>Count</th>
<th>Percent</th>
<th>IB Serv./Past 12 Mos.</th>
</tr>
</thead>
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<td><strong>BUY</strong></td>
<td>1188</td>
<td>54.80%</td>
<td>333</td>
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<tr>
<td><strong>HOLD</strong></td>
<td>830</td>
<td>38.28%</td>
<td>163</td>
</tr>
<tr>
<td><strong>UNDERPERFORM</strong></td>
<td>150</td>
<td>6.92%</td>
<td>15</td>
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