DowDuPont CEO & CFO Analyze 1st Quarter 2018 Earnings

First Quarter 2018 Earnings
DowDuPont
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Quarterly Earnings Conference Call/Webcast with
Investors, Financial Analysts and the Media
Remarks By:

Ed Breen, CEO
Howard Ungerleider, CFO
Greg Friedman, Vice President, Investor Relations
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G. Friedman

Good morning everyone. Thank you for joining us for our first quarter 2018 earnings call. DowDuPont is making this call available to investors and media via webcast.

We have prepared slides to supplement our comments on this call. These slides are posted on the investor relations section of DowDuPont’s website and through the link to our webcast.

Speaking on the call today are Ed Breen, Chief Executive Officer and Howard Ungerleider, Chief Financial Officer. Also with us in the room for Q&A are Andrew Liveris, Director and former Executive Chairman; Jim Fitterling, Jim Collins and Marc Doyle, Chief Operating Officers for DowDuPont’s Materials Science, Agriculture, and Specialty Products divisions, respectively; and Neal Sheorey, Vice President of Investor Relations.

Please read the forward-looking statement disclaimers contained in the 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 risk and uncertainty, our actual performance and results may differ materially from our forward-looking statements. Our 10-K, and each of Dow’s and DuPont’s, include a detailed discussion of principal risks and uncertainties which may cause such differences.

Also, we will comment on segment results on a divisional basis so please take note of the divisional disclaimer in our earnings release and slides.

Unless otherwise specified, all historical financial measures presented today are on a pro forma basis, and all financials, where applicable, exclude significant items. We will also refer to non-GAAP measures. A reconciliation to the most directly comparable GAAP financial measure and other associated disclosures are contained in our earnings release and on our website.

I will now turn the call over to Ed ...
E. Breen

Thanks, Greg, and thanks everyone for joining the DowDuPont first quarter earnings call.

I’ll start by covering the financial highlights. Then I’ll provide an update on our progress toward the key strategic drivers: the synergies, our growth plans and intended spins. I’ll then hand it over to Howard to discuss the quarterly results in more detail.

This past quarter marked the second full quarter of operations for DowDuPont, and the teams have come together well, and they again delivered strong results.

As shown on slide 4, here are the first-quarter highlights:

- Sales increased 5 percent to $21.5 billion
- Price rose 3 percent, with gains in all geographies and most segments
- Operating EBITDA increased 6 percent
- And we grew our adjusted operating EPS 7 percent.

Our results this quarter were due to strong performance from the Materials Science and Specialty Products divisions. Their growth more than overcame severe cold weather in the Northern Hemisphere, which shifted Ag shipments from the first quarter to the second quarter.

Our performance in the quarter was driven by solid execution, disciplined price/volume management, cost synergies, growth projects, and contributions from our value-added, customer-driven innovations.

In Materials Science, the division benefitted from strong innovation and product launches, and from broad-based price and volume gains supported by new capacity in the U.S. and the Middle East. A few examples of product innovations in the quarter include: Packaging & Specialty Plastics launched a new BYNEL® tie layer developed to provide improved adhesion between polyolefins and PET and polyamide materials in food and specialty packaging films; Polyurethanes introduced a new VORATEC™ Appliance Insulation System with a major appliance manufacturer, which provides superior energy efficiency; and in Consumer Solutions, we introduced AgeCap™ smooth cosmetic ingredient, which softens the appearance of wrinkles, while promoting skin glow and softness.

In Specialty Products, our innovation machine continues to produce numerous product line extensions that support strong top line growth. For example, Intexar added flexible heat in garments for athletes, while Gelcarin excipients made pills more palatable. A new Hytrel product made turbo gas air ducts flexible and lightweight, while the new Nomex Nano aramid reduced the weight and bulk of firefighter gear.

In Ag, our combined industry-leading pipeline is poised to deliver. Our near-term pipeline is expected to continue to launch new products through the end of the year. This pipeline is expected to deliver stronger growth in the second half of the year from new products like Zorvec, Vessarya and Arylex, which, combined, will contribute greater than $1 billion of peak sales.

Another highlight for the quarter was our progress on cost synergies. We generated savings of more than $300 million in the quarter, once again ahead of our target. Based on this progress, we now expect to realize year-over-year cost synergy savings of $1.2 billion, an increase of 20 percent from our prior target of $1.0 billion, with the majority of the increase being realized in the first half. Further, we are
also raising our Year 1 run-rate forecast to 75 percent of our recently increased $3.3 billion target. We remain very confident in our ability to hit the higher $3.3 billion run-rate by the end of Year 2.

We also continue to advance our work on growth synergies across the company. We continue to expect to deliver growth synergies, totaling $1 billion of EBITDA, over the next few years.

On slide 5, I want to share several updates on the growth potential we still see in front of us.

During the quarter we advanced our plans to deliver approximately half of the growth synergies from the Ag division. In addition, to increased market access for our broadened set of products, we are also driving opportunities to expand our portfolio through actions such as enhancing our seed treatment offerings by leveraging a larger proprietary portfolio of crop protection actives. Additionally, we are establishing new business models by executing on plans to rebuild our share lost through divestments with actions such as establishing Brevant®, our new global retail seed brand.

In Materials Science, the integration of DuPont’s ethylene copolymers affords us the opportunity to provide a one-stop shop for our packaging customers, with the broadest suite of differentiated polyethylene offerings across virtually all food, specialty and consumer packaging applications. We also see strong potential to expand our growth in polymer modifiers in infrastructure, enhancing resiliency and durability. And we will improve our solutions across a range of consumer applications, from footwear to cosmetics, where Dow technologies and DuPont co-polymers together will improve multiple aspects of performance and comfort, ultimately advancing our leadership position in these markets.

We also laid out plans for specific growth synergies in Specialty Products, which we expect to total $400 million. We’re encouraged by the fact that we already are seeing benefits in areas like electronics, where we are building deeper relationships with customers that overlap in the semiconductor and interconnect solutions businesses. As we look ahead, we will be taking advantage of cross-selling and new product development opportunities in construction and filtration as well as automotive, electronics and medical. And we’ll leverage key account management and channel access in food and pharma, to name a few.

Now I will provide an update on our progress with standing and spinning the intended companies as presented on slide 6.

We continue to anticipate Materials Science separating by the end of first quarter of 2019, followed by Agriculture and Specialty Products separating shortly after that – by June 1 of 19.

The objectives for us between now and the fall include assigning assets and liabilities to each intended company, negotiating terms of the necessary agreements among the three intended companies, and completing IT system design, testing and implementation. We have been doing a lot of work in this area, and we remain on track.

We continue to make progress on setting up the capital structure of each company. This work includes the separation of heritage DuPont assets and liabilities into agriculture and specialty products, the movement of Dow AgroSciences into Agriculture, and any other adjustments prompted by the portfolio realignment we announced last year.
Talent selection is substantially complete; our employees know which intended company they are aligned to and are focused on delivering results.

In summary, our businesses are performing well. We’re executing against our financial and operational commitments. We are excited about our cost savings delivery and growth synergy potential. And we are pleased with the team’s progress as we move toward the intended separations.

Finally, I want to address something that is important to me on a personal level. I want to be clear that I intend to be around through the intended spins, and beyond. I am committed to making sure the three intended companies are properly launched and I plan to be actively involved after the final separations. There is a lot of value to be created for our shareholders, and my personal goal is to see it through.

With that, let me turn it over to Howard to review our financial results in further detail.

H Ungerleider

Thanks, Ed. Moving to slide 7 and a summary of our first quarter results.

We once again grew earnings per share, net sales and EBITDA.

Drivers of the EPS increase include: local price and volume gains in Materials Science and Specialty Products; cost synergies; a currency tailwind; higher equity earnings; and lower pension/OPEB costs. These gains more than offset the weather-related shift we saw in Agriculture; higher feedstock costs; and the impact of the freeze-related outages on the U.S. Gulf Coast.

The sales increase of 5 percent was broad-based, with growth in most operating segments and geographies. Sales rose 15 percent, excluding Ag, with double-digit gains in both Materials Science – up 17 percent – and Specialty Products – up 11 percent. The sales decline in Agriculture was driven by weather-related delays to planting seasons in the Northern Hemisphere and Brazil.

Overall volume declined 2 percent, driven by the decline in Ag. Materials Science achieved 14 percent volume growth in Industrial Intermediates & Infrastructure and 8 percent growth in Packaging & Specialty Plastics in spite of weather-related supply disruptions, enabled by new capacity adds from Sadara and on the U.S. Gulf Coast. Specialty Products delivered volume gains in all segments on solid customer demand in its four market verticals, which more than offset weather-related shifts in demand, particularly aligned to construction end-markets.

Local price increased 3 percent, led by Materials Science, which was up 5 on strong supply/demand fundamentals across most of its targeted end-markets.

Equity earnings increased, led by improved Sadara results and increased earnings from the Kuwait joint ventures.

And the cost synergies continue to hit the bottom-line, as we have now delivered more than $500 million of cumulative savings since merger close.
These gains translated to operating EBITDA of $4.9 billion in the quarter. Excluding Ag, operating EBITDA increased 26 percent year-over-year, with double-digit gains in both Materials Science and Specialty Products.

Our cash flow from operations was down, primarily due to higher integration and separation cost spending and a one-time tax payment. The underlying cash from operations of our businesses improved versus the same quarter last year. And from an efficiency perspective, we are improving our turns by 2 days year-over-year as the divisions continue to focus on driving strong working capital discipline.

Finally, we returned nearly $2 billion of cash to our shareholders in the first quarter, which included another $1 billion of share repurchases. And looking ahead, we will target another $1 billion of buybacks in the second quarter.

Moving now to our division and segment results, starting on slide 8. The Materials Science division achieved double-digit top- and bottom-line growth in the quarter; advanced its growth projects; and delivered ahead of plan on its cost synergy efforts.

First quarter net sales rose 17 percent from the year-ago period, with double-digit gains in all segments and gains in all geographies. Volume grew 8 percent and local price rose 5 percent, both up in all geographies and both led by double-digit increases in Industrial Intermediates & Infrastructure. In addition to solid demand in its core markets, Materials Science also saw a boost from new capacity adds in the U.S. and the Middle East. The division delivered these results in spite of weather-related supply disruptions in the United States.

Equity earnings rose year-over-year. The largest positive contributor was Sadara, which improved by $80 million, putting the JV on track for its expected year-over-year improvement.

Operating EBITDA for Materials Science grew 23 percent versus the same quarter last year to $2.6 billion, with double-digit gains in every segment.

Turning now to the segments.

Performance Materials & Coatings achieved operating EBITDA of $628 million, up 31 percent from the year-ago period, primarily due to increased pricing, improved product mix and cost and growth synergies.

Consumer Solutions delivered double-digit sales growth led by local price gains and disciplined price/volume management in upstream silicone intermediate products.

Industrial Intermediates & Infrastructure delivered operating EBITDA of $654 million, up 28 percent from the year-ago period. Pricing actions, cost synergies and improved equity earnings led to a strong quarter despite the impact of weather-related outages on the U.S. Gulf Coast, higher raw material costs and increased maintenance and turnaround activity in the quarter.

Both Polyurethanes and CAV and Industrial Solutions delivered robust sales growth on double-digit gains in all geographies, driven by broad-based local price and volume gains. Demand growth was particularly strong in Asia Pacific and EMEA, driven by the contributions from the new capacity at Sadara. Price increases in downstream, higher-margin systems applications led the performance in Polyurethanes.
The Packaging and Specialty Plastics segment achieved operating EBITDA of $1.3 billion, up 17 percent from the year-ago period. Polyolefin and elastomers price increases; volume gains, including the benefit of supply from growth projects; lower commissioning and startup costs; higher equity earnings; and cost synergies more than offset increased feedstock costs.

The Packaging and Specialty Plastics business grew volume in all geographies on broad-based demand strength, supported by new capacity additions on the U.S. Gulf Coast and increased Sadara production. Local price was up as increases in ethylene derivatives in the Americas more than offset moderate declines in EMEA and Asia Pacific. Demand growth was led by food and specialty packaging and industrial and consumer packaging end-markets in Asia Pacific and EMEA, as well as rigid packaging applications in all regions.

The business also continued to startup its investments on the U.S. Gulf Coast. The new world-scale cracker and ELITE polyethylene train, which came online late last year, both ran at high rates through the first quarter and contributed to the bottom-line. The next two assets – the NORDEL EPDM and the high-pressure low density facilities – both came online in the first quarter, and product from both assets has already been flowing into the market. The new low density facility has ramped up to full operating rates, and the NORDEL asset is expected to complete the full range of customer qualifications in the second quarter.

Looking ahead, our next two capacity additions on the U.S. Gulf Coast are progressing well. The gas-phase debottleneck in Louisiana remains on track to be complete mid-year ... and our new world-scale specialty elastomers unit in Texas is expected to startup towards year-end.

Turning to slide 9. Specialty Products also delivered double-digit top- and bottom-line growth by staying close to its customers and applying its innovation power to solve their toughest problems. The division achieved these results while advancing the multifaceted integration of the heritage Dow and FMC businesses, highlighting the intense focus on execution.

The division reported first-quarter net sales of $5.6 billion, up 11 percent from the year-ago period, with gains in all regions and most segments. Volume grew 3 percent and local price rose 2 percent. Currency added another 4 percent, and portfolio another 2 percent. Organic sales growth was led by Transportation & Advanced Polymers, up 8 percent, with Nutrition and Biosciences, up 5 percent.

First-quarter operating EBITDA for the division grew 25 percent to $1.6 billion versus the same quarter last year, with gains in every segment.

Turning now to the segments in Specialty Products.

Electronics and Imaging net sales declined 1 percent as volume, price and currency gains were more than offset by portfolio. Organic sales increased 2 percent, driven by demand for our highly-engineered solutions for semiconductor, which grew double-digits, as well as gains in consumer electronics, industrial and transportation markets. This more than offset softness in photovoltaic applications. Operating EBITDA increased 9 percent to $357 million in the quarter.

Nutrition and Biosciences net sales increased 21 percent in the quarter to $1.7 billion. Volume and local price together contributed 5 percentage points on growth in both Nutrition and Health and Industrial
Biosciences. Net sales also included a 4 percent benefit from currency and a 12 percent benefit from portfolio, representing the acquisition of FMC’s Health and Nutrition business. The integration of these businesses continues to progress well. Operating EBITDA grew 32 percent to $418 million in the quarter.

Transportation and Advanced Polymers reported net sales of $1.4 billion, up 14 percent. Volume grew 3 percent, driven by double-digit gains in the automotive market, amid strong demand for engineering polymers, specialty lubricants and structural adhesives, with growth in all regions. Our differentiated capabilities in light weighting and electrification, coupled with an increase in SUVs and pickup truck builds, helped fuel our strong performance. Operating EBITDA totaled $437 million, an increase of 36 percent. This growth was driven by lower pension/OPEB costs, favorable currency and gains from disciplined price/volume management, which more than offset higher feedstock costs. Beyond share gains and new applications driving volume growth, supply is tight for Nylon and compounds, and other key raw materials are constrained. We’ve been accelerating investments in capacity and reliability and have a strong track record of meeting customers’ growth needs.

Safety and Construction sales rose 7 percent to $1.3 billion. Operating EBTDA of $354 million rose 21 percent, reflecting lower pension/OPEB costs, execution of cost synergies, improvements in the reliability of the plants and favorable currency, partly offset by higher raw material costs.

Looking ahead, we are preparing targeted high-ROIC capacity expansions across the portfolio to meet rising demand from customers for our highly-engineered materials and naturally sourced, biotechnology-based specialty food ingredients. We are outperforming in many industries due to our focus on application development and deep customer intimacy. We also are debottlenecking plants to keep up with rising customer demand in key markets, including automotive, electronics, medical, oil and gas and food and nutrition. And we continue to execute our asset reliability program in our manufacturing facilities to improve performance, unlock capacity for constrained products and maintain high service level to customers.

Turning to Ag.

Let me start by covering the weather-related drivers across the Northern Hemisphere and Brazil as illustrated on slide 10, which caused the top- and bottom-line decline we saw in Ag this quarter. The weather affected our U.S. operations the most, as the unseasonably cold spring in the U.S. delayed a significant portion of the planting season by approximately three to four weeks. This resulted in a material delay in our seed deliveries to our farmer customers during the first quarter.

To put this in perspective, through our advantaged route-to-market, Pioneer brand sales reps typically deliver seed to growers within only a few days of planting. And in a normal season, we deliver the majority of our total North America corn volume over a four-week period between the end of March and early April, which straddles our fiscal quarter end.

This year, planting did not start in earnest until recently, which means a large portion of our Seed sales in North America was shifted into the second quarter. Typically about 75 percent of U.S. corn is planted by mid-May, and with all of the advancements in farming practices and equipment, we expect farmers should be able to accelerate the pace of planting to enable this year’s crop to be in the ground by then. And in fact we have seen a steep increase in seed deliveries over the past two weeks.
Weather also had an impact on our Crop Protection business, as farmers pushed out their Nitrogen Stabilizer applications and spring pre-emergent herbicide applications.

And in Brazil, the delayed summer harvest shortened the safrinha season, resulting in lower planted area, as well as a shift toward lower-technology corn as farmers moved to minimize the impact of lower yields due to the reduced growing time.

Turning now to slide 11, this broader market backdrop explains Ag’s first quarter net sales decline of 25 percent and operating EBITDA decline of 39 percent, compared with the same quarter last year. Helping to offset some of the weather-related downside in the quarter was: our continued leadership position in sunflower seeds in Europe ... and expanding our portfolio of global insecticide sales, following our merger remedy, with strong growth in technologies such as Isoclast™, Spinosad™ and Spinetoram™ during the quarter.

Looking ahead to the second quarter, we expect operating EBITDA to be up in the high-thirties percent range, and factoring in the weak Safrinha season and lower expected planted area in North America, we now expect full year operating EBITDA to be up in the high-single to low-teens percent range driven by the strength of new product launches and realization of cost synergies as the year continues to progress.

Turning now to our modeling guidance on slide 12.

We expect continued healthy demand across the vast majority of our end markets, as well as pricing gains across most of our businesses. We continue to see synchronous global growth and numerous positive leading indicators. Our broad, consumer-driven portfolio benefits from that. And we see our innovations and growth investments driving above-market growth. At the company level, we see second quarter net sales to be in the range of $23.3 to $24.0 billion ... up more than 10 percent. Second quarter operating EBITDA is expected to be up more than 20 percent year-over-year to $5.3 to $5.5 billion, based on our volume growth, pricing gains, continued ramp of our cost synergies, and the innovations we are continuing to bring to market across each of our divisions.

Having just covered our Ag expectations, I will focus my comments on the other two divisions.

The Materials Science division expects continued earnings contributions from underlying end-market growth, the U.S. Gulf Coast startups and an improvement in equity earnings, led by Sadara. This will be partly offset by higher spending year-over-year of between $130 and $150 million as we enter a heavy turnaround season, primarily in the Packaging & Specialty Plastics segment. In polyolefins, global demand remains robust and keeps pace with new industry capacity additions. And in the polyurethanes chain, we expect improving supply conditions in the second half to relieve very tight isocyanates fundamentals.

The Specialty Products division is forecasted to grow the top line by the high-single digits percent driven by continued demand from end markets, application development and new product introductions. Operating EBITDA is expected to improve by about 20 percent. Volume and pricing gains and lower pension/OPEB costs are expected to be partially offset by higher raw material costs and the absence of a one-time gain in the Electronics and Imaging segment.

Looking across all three divisions ... while trade and tariff topics have been in the headlines, we believe the potential impact on DowDuPont will not be material to our businesses.
From a cost synergy perspective, we anticipate delivering between $325 and $350 million of year-over-year savings in the second quarter. This is a strong start, and remember that Ag synergies begin to ramp in the back-half of the year and through the next North American planting season.

Please refer to slide 15 in the appendix for further commentary on our outlook for the second quarter.

And with that, I’ll now turn it back to Ed.

E. Breen

Great, thanks, Howard.

To close the call, I want to take a moment to acknowledge Andrew Liveris and recognize his more than 40 years at the company and 14 years as chairman and CEO of Dow. Andrew was a major architect of our deal and has been a strong partner in the past couple years as we navigated a very robust antitrust approval process and ultimately made our vision of a merger of equals, with the setup of the subsequent spins, a reality. I appreciate everything he’s done to help deliver the value of this transaction. And, Andrew, on behalf of everyone on this call and all our shareholders, thank you.

With that, let me turn it to Neal to open the Q&A.

N Sheorey

Thank you, Ed.

With that, let’s move on to your questions. First, 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.

Close

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

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