DowDuPont, Inc. (DWDP)

Updated August 12th, 2018 by Josh Arnold

Key Metrics

Current Price:	$68	**5 Year CAGR Estimate:**	7.1%	**Volatility Percentile:**	43.9%
Fair Value Price:	$67	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	42.5%
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.1%	**Valuation Percentile:**	60.7%
Dividend Yield:	2.2%	**5 Year Price Target**	$86	**Total Return Percentile:**	41.4%

Overview & Current Events

DowDuPont is the product of a late-2017 merger that combined the former Dow Chemical Company and E.I. du Pont de Nemours & Company. Together, they are a diversified chemical production entity with ~$85 billion in annual revenue and a $156 billion market capitalization. In addition, the company is underway with plans to split DowDuPont into three separate entities by late-2019. The three separate businesses will be called Corteva Agriscience, Dow, and DuPont, which are currently the agriculture business, materials science segment and specialty products division, respectively.

DowDuPont reported Q2 earnings on 8/2/18 and results were strong, but the stock was hit from guidance for higher raw material costs. Total revenue was up 17% in Q2 with increases in all divisions, as volume increased 10% and pricing was strong as well. Adjusted earnings-per-share rose 41% to $1.37 and operating EBITDA was up 29%, with double-digit increases in all segments. Management also boosted its predicted cost savings from the merger to $1.4 billion from $1.2 billion. Guidance was for higher currency fluctuations and raw material costs, so investors are worried about the company's margins. We've slightly lowered our gross margin forecast for this year, but earnings estimates are unchanged given the strong pricing and volume present in Q2.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.62	$0.32	$1.72	$2.05	$0.71	$3.68	$2.87	$3.32	$3.52	$3.07	***$3.85***	***$4.90***
DPS	--	--	--	--	--	--	--	--	--	$0.38	***$1.52***	***$2.00***

DowDuPont's earnings-per-share history shows a company that has not produced a lot of growth in recent years. The merger took place last year, bringing two chemical giants together and the synergies it created are helping to drive growth in 2018. However, the planned separation of the current business into three has created a unique situation.

We see DowDuPont producing 5% annual earnings-per-share growth combined over the next few years, although when the companies are split off, growth rates will surely differ between them. DowDuPont should achieve this growth primarily through sales increases, which we believe will be in the mid-single digits for the foreseeable future. Recent weakness in the agricultural business should be temporary as prices continue to increase and light volume was weather-related. Indeed, Q2's results would suggest this is already beginning to happen. The company's exposure to consumer markets like mobile devices is a long-term positive. In addition, the world's growing middle class should afford plenty of growth opportunities for DowDuPont, even after the spinoffs are complete. A lower tax rate will help boost earnings this year but moving forward, we think margins will remain steady given volatile input costs and that sales growth will be the primary lever it can pull to boost earnings.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	24.3	86.3	19.8	14.0	45.5	12.1	15.9	15.5	16.3	17.7	***17.6***	***17.5***
Avg. Yld.	--	--	--	--	--	--	--	--	--	0.7%	***2.2%***	***2.3%***

DowDuPont's shares look to be trading right at fair value today, which we estimate at 17.5 times earnings. We therefore see a very small 0.1% headwind to total returns moving forward from the valuation, essentially having no impact. When the three businesses are spun off, they will almost certainly have different valuations but for now, we see this stock as fairly valued. The yield is just above two percent after a huge dividend increase this year and that is where we believe it will remain. DowDuPont is paying around 40% of its earnings as dividends and we do not see that increasing materially.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	9.5%	12.8%	14.7%	14.9%	15.8%	16.6%	18.4%	22.6%	21.8%	15.2%	***14.5%***	***15.0%***
Debt/A	70%	68%	67%	66%	69%	60%	66%	61%	66%	47%	***47%***	***45%***
Int. Cov.	3.4	1.3	3.0	3.8	2.4	7.5	6.7	12.4	7.0	2.4	***2.5***	***2.8***
Payout	--	--	--	--	--	--	--	--	--	12%	***39%***	***41%***
Std. Dev.	40%	99%	30%	35%	26%	21%	22%	26%	22%	12%	***20%***	***28%***

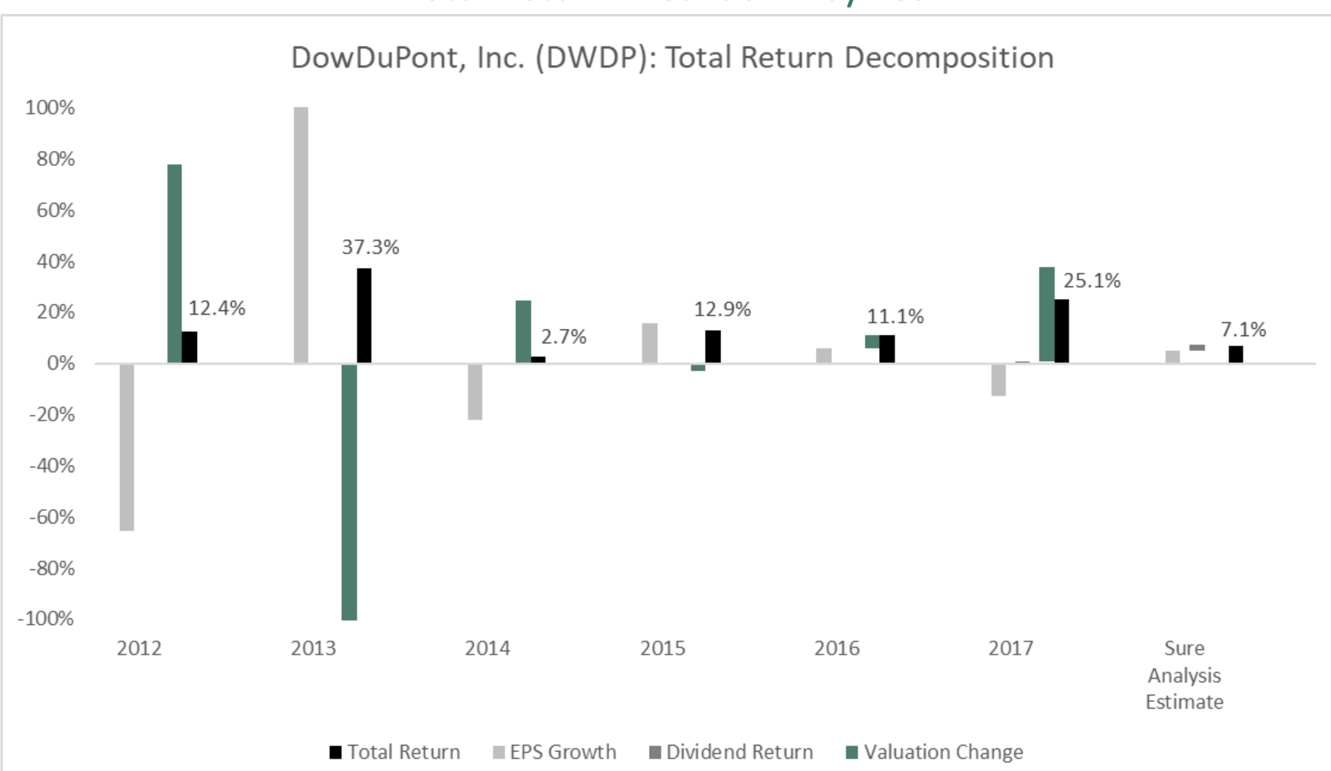
DowDuPont's quality metrics shifted significantly in some cases after the merger was completed. The company now has less than half of its assets financed by liabilities, so its balance sheet is much more robust. Interest coverage, however, has declined as the debt the company has is more expensive to service relative to operating income. Likewise, the combined margin profile of the companies has deteriorated somewhat, although we do not believe further deterioration is likely. The dividend is very safe and we think the payout ratio will remain roughly where it is.

DowDuPont's competitive advantage is in its very long operating histories in the industries in which it operates. It has built tremendous expertise in a variety of specialty chemical businesses that have strong long-term outlooks. We think the spinoffs will be positive for shareholders of DowDuPont given the businesses will be pure-plays on their respective lines. Recessions are not kind to chemical makers and DowDuPont is no exception, as earnings were cut in half in 2009.

Final Thoughts & Recommendation

Overall, DowDuPont looks fairly valued here after years of nice returns. We are forecasting 7.1% total annual returns moving forward, consisting of the current 2.2% yield, 5% earnings-per-share growth and a 0.1% headwind from the valuation. The spinoffs of the three separate businesses should help unlock some value and we like the plan to do so. However, we rate DowDuPont as a hold today because of the full valuation and moderate growth prospects.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.