Dow Inc. NYSE:DOW

FQ1 2023 Earnings Call Transcripts

Tuesday, April 25, 2023 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-		-FY 2022-		-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.57	NA	NA	0.37	6.40	NA	NA	3.20
Revenue (mm)	12045.55	NA	NA	11340.12	57208.58	NA	NA	49953.81

Currency: USD
Consensus as of Apr-20-2023 12:54 PM GMT

	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ1 2022	2.05	2.34	14.15 %
FQ2 2022	2.14	2.31	7.94 %
FQ3 2022	1.15	1.11	(3.48 %)
FQ4 2022	0.57	0.46	(19.30 %)

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Presentation

Operator

Greetings, and welcome to the Dow's First Quarter 2023 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

I will now turn it over to Dow Investor Relations Vice President, Pankaj Gupta. Mr. Gupta, you may begin.

Pankaj Gupta
Vice President of Investor Relations

Good morning. Thank you for joining Dow's first quarter earnings call. This call is available via 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'm Pankaj Gupta, Dow Investor Relations Vice President. And joining me today on the call 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 will also refer to non-GAAP measures. A reconciliation of 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 as well as on the Dow website.

On Slide 2, you will see the agenda for our call. Jim will begin by reviewing our first quarter results and operating segment performance. Howard will then share our outlook and modeling guidance. To close, Jim will outline how our decarbonize and grow and transform the waste strategies enable continued value creation. Following that, we will take your questions.

Now let me turn the call over to Jim.

James R. Fitterling
Chairman & CEO

Thank you, Pankaj. Beginning on Slide 3. In the first quarter, Team Dow demonstrated its agility delivering sequential earnings improvement in what continues to be a challenging environment. These results reflect our competitive advantages and operating discipline as we leveraged our structurally advantaged feedstock positions proactively aligned our operating rates with market demand and focused on higher value products where pockets of demand remained resilient, such as pharmaceutical applications, energy, commercial building and construction and mobility end markets.

Additionally, our actions to deliver $1 billion in cost savings in 2023 are progressing with $100 million achieved in the first quarter. These actions will ensure we continue to focus on cash flow generation through our low-cost-to-serve operating model.

Turning to the details of the quarter. Net sales were $11.9 billion, down 22% year-over-year. Declines in all operating segments were driven by continued soft global macroeconomic activity. Sales were flat sequentially as gains in Performance Materials & Coatings and Packaging & Specialty Plastics offset declines in Industrial Intermediates & Infrastructure. Volume decreased 11% year-over-year led by declines in Europe, the Middle East, Africa and India or EMEAI. However, volumes increased 2% sequentially on gains in Performance Materials & Coatings and Packaging & Specialty Plastics. Local price declined 10% year-over-year and 4% quarter-over-quarter due to industry supply additions and some businesses amidst soft global economic conditions.

Operating EBIT for the quarter was $708 million, down year-over-year due to lower local prices and volumes. Sequentially, operating EBIT improved by $107 million with gains primarily driven by Performance Materials and Coatings. Cash flow from operations was $531 million in the quarter. On a trailing 12-month basis, cash flow conversion was 85%. With ample financial flexibility and a strong balance sheet, we are continuing to execute on our strategy as we advance our disciplined and balanced capital allocation priorities for long-term value creation. We returned $621 million to shareholders through dividends and share repurchases during the quarter, and our balance sheet continues to have no substantive long-term debt maturities until 2027.

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Now turning to our operating segment performance on Slide 4. In the Packaging & Specialty Plastics segment, operating EBIT was $642 million compared to $1.2 billion in the year-ago period, primarily due to lower integrated polyethylene margins. Continued margin resilience in Functional Polymers was more than offset by lower polyethylene and olefins margins. Volume declines were primarily driven by lower consumer demand in EMEAI. Sadara also had lower export volumes due to planned maintenance activity. Sequentially, operating EBIT was down by $13 million. Improved input costs and higher operating rates in our most cost-advantage assets were more than offset by lower sales from nonrecurring licensing activity and lower equity earnings.

Moving to the Industrial Intermediates & Infrastructure segment. Operating EBIT for the segment was $123 million compared to $661 million in the year-ago period. Results were driven by lower pricing and demand as well as higher energy costs, particularly in EMEAI. Sequentially, operating EBIT was down $41 million. Lower energy costs were more than offset by decreased demand and pricing for propylene oxide, its derivatives and in isocyanates and polyurethanes and construction chemicals.

Industrial Solutions experienced lower volumes due to weather-related impacts and a third-party supply outage combined with lower demand in industrial end markets. And in the Performance Materials & Coatings segment, operating EBIT for the segment was $35 million compared to $595 million in the year ago period. Local price declines for siloxanes were driven by competitive pricing pressure from supply additions in China. Volume was down as resilient demand for commercial building and construction, mobility and industrial coatings was more than offset by volume declines in siloxanes and architectural coatings. Sequentially, operating EBIT increased $165 million, driven by improved supply availability, seasonally higher volumes and reduced value chain destocking.

Next, I'll turn it over to Howard to review our outlooks and actions on Slide 5.

Howard I. Ungerleider
President & CFO

Thank you, Jim, and good morning, everyone. In the second quarter, we expect to continue navigating challenging macro conditions around the world. While the pace of inflation has slowed, elevated levels continue to pressure both input costs and demand, particularly in industrials, durable goods and housing. On the bright side, demand in agriculture and energy markets remains resilient as does consumer demand for personal care and household items.

In the U.S., consumer spending continues to moderate, while retail sales were up 2.9% year-over-year in March. After contracting for 5 straight months, normalizing value chain inventories are driving improvements in manufacturing PMI which reached 50.4 in April. Residential building and construction markets remain under pressure, with housing starts and building permits down around 20% year-over-year in March. However, builder confidence increased for the fourth straight month in April on growing demand in the new home market due to limited resale inventory.

In Europe, while energy prices have remained lower than previously anticipated, higher inflation levels continue to weigh on both consumer and business sentiment with manufacturing PMI continuing to contract since July of last year. In China, March industrial production rose 3.9% year-over-year and is recovering gradually with manufacturing PMI now at 50. March retail sales also rose 10.6% year-over-year at their fastest pace since July 2021. Though recovery following the pandemic lockdowns has been slow, we continue to expect growth over the medium term. Against this backdrop, we continue to take disciplined actions to manage our costs and deliver our target of $1 billion in cost savings in 2023.

We're implementing our global workforce reduction program of approximately 2,000 roles. Notifications have begun and 75% of the impacted roles will exit by the end of the second quarter. We're also continuing to review our global asset footprint on a business-by-business and region-by-region approach, rationalizing select higher-cost, lower-return assets in line with market fundamentals. Additionally, we're executing opportunities to reduce operating costs. This includes decreasing maintenance turnaround spending by $300 million year-over-year and driving efficiencies through the value chain, including streamlining our logistics networks and reducing our spend of purchased raw materials and contract services. All in, we expect to deliver approximately 35% of our cost savings in the first half of the year and the remaining 65% in the second half of the year.

Turning to our outlook for the second quarter on Slide 6. In the Packaging & Specialty Plastics segment, we see signs of improving domestic demand versus the start of the year as well as continued easing in marine pack cargo, allowing for increased export volumes. We expect healthy oil-to-gas spreads to continue to favor our cost-advantage positions as rates increase to meet seasonally higher demand levels. All in, we expect these factors to have a $75 million tailwind versus the prior quarter, along with another approximately $70 million tailwind from cost savings actions. We anticipate these will be partly offset by a $25 million headwind from a seasonal increase in planned maintenance activity.

In the Industrial Intermediates & Infrastructure segment, demand remains resilient in energy and pharmaceutical end markets. However, we expect continued demand pressure in consumer durables and building and construction, which is also driving a decline

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in cost pricing from its recent peak. We anticipate a $25 million tailwind from improved volumes in Industrial Solutions following third-party outages and the winter weather-related impacts as well as a $20 million tailwind from cost savings actions. Additionally, Dow will begin to turnaround at our Louisiana Glycols facility, which is projected to be a $50 million headwind for this segment.

In the Performance Materials & Coatings segment, while demand for consumer electronics and industrial end markets is softening, we're seeing a seasonal increase in demand for coating applications as well as improvement in mobility. Our cost saving actions will deliver a $50 million tailwind for the segment. The completion of our first quarter turnaround at our Deer Park acrylic monomers facility will be offset by impacts from the planned maintenance at our Carrollton and Zhangjiagang siloxanes facilities. All in, with the puts and takes mentioned and listed on our model and guidance slide, we expect a sequential earnings improvement of $150 million to $200 million versus the prior quarter.

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

James R. Fitterling
Chairman & CEO

Thank you, Howard. Moving to Slide 7. While we expect near-term conditions to remain challenging through the year, we continue to see positive underlying demand trends driving above GDP growth across our attractive market verticals over the next few years. Packaging is vital to delivering a lower carbon footprint. Through our 3 million metric ton transform the waste commitment, we will capture demand growth for recycled polyethylene, which is accelerating as brand owners and customers increasingly seek more circular products.

In infrastructure, more than $3 trillion in investments will be needed to meet global infrastructure plans. Green buildings are driving demand for Dow products including low-carbon footprint silicone sealants for high-rise buildings, reflective roof coatings and lower carbon emissions cement additives. An expanding middle class will support growth in consumer spending where our products help deliver a lower carbon footprint and enable more sustainable materials through technologies such as biodegradable polymers or bio-based surfactants for home care and thermal conductive silicone gels and adhesives for electronics and batteries.

And in mobility, stable global vehicle production growth is expected. With increasing demand for electric vehicles, which contain 3 to 4x more silicone content than internal combustion engine vehicles. Lighter weight vehicles are also aided by our high-value polyurethane systems and EPDM technologies. Further, we continue to execute our targeted suite of higher-return, lower-risk projects which are expected to add $2 billion in underlying EBITDA by the middle of the decade. These investments put us in an advantaged position to capture demand as economies recover and raise our underlying earnings profile.

Turning to Slide 8. With growing consumer and brand owner demand for more sustainable and circular products leading in the transition to a more sustainable future remains critical to our strategy to drive growth and shareholder value creation. In collaboration with X-energy, in the second quarter, we expect to select and announce a site in the U.S. Gulf Coast to develop a small modular nuclear energy facility by 2030. Nuclear technology will be key in generating safe and reliable power and steam at our sites while enabling zero CO_2 emissions manufacturing.

In Alberta, we recently ordered Fluor with a contract to provide front-end engineering and design services for our Path to Zero project. Today, we achieved another key milestone by selecting Linde as our industrial gas supplier to supply nitrogen and clean hydrogen for the site. Securing partner agreements and subsidies is our next step. All of these actions are critical to reaching a final investment decision this year. As a reminder, this investment for the world's first net zero CO_2 emissions ethylene and derivatives complex will decarbonize 20% of our global ethylene capacity. At the same time, it will grow our global polyethylene supply by 15% and triple our Alberta site polyethylene capacity.

We're also taking a capital-efficient approach to meet increasing demand for more circular solutions as we scale up production for both advanced and mechanical recycling with strategic partners like Valoregen, Mura Technology and WM among others. Valoregen's 15-kiloton mechanical recycling facility in France will start up during the second half of this year. This hybrid recycling plant is expected to process up to 70 kilotons of plastic waste per year by 2025. And Mura remains on track to start up the first of its kind, 20-kiloton per year advanced recycling plant in Teesside in the United Kingdom in the second half of this year. This is the first step in our strategic partnership with Mura to launch as much as 600 kilotons per year of advanced recycling capacity by 2030.

As the key off-taker of post-consumer and advanced recycled feed from both of these partnerships, Dow will commercialize circular polymers and high demand from global brands. Altogether by 2030, we are on track to deliver an additional $1 billion in underlying EBITDA improvement through our Alberta project, commercialized 3 million metric tons per year of circular and renewable solutions and reduce Scope 1 and 2 CO_2 emissions by 5 million metric tons compared to our 2020 levels.

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Turning to Slide 9. We remain focused on delivering on our commitments with transparency, accountability and a culture of benchmarking. Today, we published our annual benchmarking update as we have every year since spin, which can be found in the appendix of this presentation and is posted on our website. The results once again demonstrate our strong performance relative to peers. In particular, Dow delivered best-in-class free cash flow yield and net debt reduction since spin. We also achieved above peer median return on invested capital and returns to shareholders.

Taking a closer look at the results on Slide 10. Our free cash flow yield on a 3-year average is nearly 2x the peer average and 3x the sector and market averages. Our differentiated portfolio, cost-advantaged assets and operating discipline have resulted in 3-year EBITDA margins and return on invested capital well above the peer median. This includes our 15% return on invested capital, which is above our 13% target across the economic cycle. Our focus on cash flow generation has supported strong shareholder returns and our strengthened balance sheet has resulted in improved credit ratings and outlooks.

Additionally, all operating segments achieved best-in-class or top quartile, free cash conversion and cost performance. Notably, Packaging & Specialty Plastics further expanded its outperformance over the next best peer on an EBITDA per pound of polyolefin basis by $0.05 per pound. It also delivered 5-year average EBITDA margins 500 basis points above the peer median. Looking forward, our growth investments throughout the decade will further enhance our competitive advantages and shareholder value creation.

Closing on Slide 11, Dow continues to execute with consistency and discipline to deliver resilient performance in the near term and sustainable growth and cash flow generation over the long term. We're implementing targeted actions across the enterprise to reduce costs and maximize cash. Our strong balance sheet provides financial flexibility as we continue to deliver against our capital allocation priorities, and our decarbonize and grow and transform the waste strategies will raise our underlying earnings profile while reducing our carbon footprint and increasing recycled content. All combined, we are confident in our ability to continue delivering against our financial targets across the economic cycle.

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

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Question and Answer

Pankaj Gupta
Vice President of Investor Relations

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.

Operator

[Operator Instructions] Our first question comes from the line of Vincent Andrews with Morgan Stanley.

Vincent Stephen Andrews
Morgan Stanley, Research Division

Wondering if you could touch a little bit more on Performance Materials & Coatings. Obviously, the segment showed very strong results on a sequential basis that were clearly better than what the Street was looking for. So if you could just give us a little bit more insight into why things turned out better than planned and just sort of what you think the trajectory is for the balance of the year?

James R. Fitterling
Chairman & CEO

Vince, good question. Obviously, we had some headwinds, obviously, in the fourth quarter in silicones with some outages that did not recur in the first quarter. So that was part of the impact. The other thing you would see in silicones was that pricing and demand held up relatively well. Some pressure downward on siloxanes pricing in China from new capacity additions there. But I think we're starting to see that the demand is picking up and that should help smooth things out.

So you also saw higher net sales in coatings and monomers and also higher volumes. Some of its supply availability, as I mentioned, in silicones and siloxanes. The other is getting ready for seasonally higher volumes going into the second quarter. And then we think we'll see more of a traditional seasonal pickup in the coatings and monomers segment. Some pressure on architectural coatings, but industrial coatings are looking relatively strong. And I think we'll have to watch carefully what's going on with housing starts and housing sales and see how that impacts architectural coatings through the quarter.

Operator

Your next question comes from the line of Hassan Ahmed with Alembic Global.

Hassan Ijaz Ahmed
Alembic Global Advisors

Jim and Howard. A question around packaging and specialty plastics. I was a bit surprised to see EBITDA being sequentially flat, keeping in mind that, obviously, we got $0.06 a pound worth of polyethylene price hikes. And ethane was down sequentially so that's sort of part 1 of the question.

And part 2 is that I'd also love to sort of hear your views on what's happening with your operating rates within sort of ethylene and polyethylene keeping in mind that you guys scaled back in Q4?

James R. Fitterling
Chairman & CEO

Good questions. P&SP did see pricing improve through the quarter in the first quarter. But obviously, in the fourth quarter, we saw things slide down through the quarter. And so a simple way to think about it is we ended the quarter really still below where we started in the fourth quarter of last year, so we did see pricing improvements. In fact, we saw $0.03 through in March, and we've got a $0.05 nomination into April. But I would say that averaging effect took away some of the impact from the oil-to-gas spreads, which are improving.

The other thing, the oil and gas spreads really improved in the month of March, primarily. We didn't see so much impact in the month of February, but the month of March, we saw that. So I would expect that to carry into the second quarter. Operating rates for the quarter were up 10 percentage points, with the biggest pressure still continuing to be in Europe because of the higher cost position there and also the lower demand in Europe.

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And I would say that's the biggest -- if you look at our volumes and not just in Packaging and Specialty Plastics, but our overall volumes in Europe year-over-year, they're down the most in Europe, and our operating rates are the lowest in Europe. As you would expect, whereas our operating rates in the U.S. Gulf Coast, Canada and Argentina, with the exception of turnaround time are continuing to be in the 90-plus percent range.

Howard I. Ungerleider
President & CFO

Hassan, 2 other points on that comparison. So don't forget that in the fourth quarter, we had the Univation catalyst and actually a licensing sale. Those are lumpy. That was about $70 million in the fourth quarter that didn't recur so that was a headwind sequentially. And then also the bulk of Q1, we had the cracker in Sadara out for a planned maintenance turnaround. So that's now back up and running and that should be a tailwind improvement in the second quarter.

Operator

Your next question will come from the line of David Begleiter with Deutsche Bank.

David L. Begleiter
Deutsche Bank AG, Research Division

Jim, the sequential increase in Q2 is a little less than normal. Where are you seeing the greatest pressures from a volume perspective in Q2 versus maybe perhaps normal seasonality?

James R. Fitterling
Chairman & CEO

Yes. I would say the biggest pressure still continues to be in II&I and more specifically in polyurethanes and construction chemicals. I'd say the one thing that may not be quite as obvious in the second quarter guidance is there's a $70 million headwind in there from Chlor-Alkali and Vinyl and we've seen some pressure, obviously, there on lower demand. And as you know, that complex operates on both caustic soda and also chlorine demand and with housing down, PVC demand being down and the pressure that puts on operating rates, brings things down.

But on the other side, obviously, we're seeing industrial uses putting some downward pressure on both demand and price and caustic soda. So I'd say they're managing it well. They're making the adjustments that they need to make and -- but that's probably the biggest difference in looking forward to Q2. I would say from a turnarounds perspective, we're in pretty good shape. Howard, do you have a comparison like on turnarounds Q2 versus Q1?

Howard I. Ungerleider
President & CFO

Yes. I mean, turnaround sequentially are going to be about a $75 million headwind, $25 million of that in P&SP and the balance in Industrial Intermediates.

Operator

Your next question comes from the line of Steve Byrne with Bank of America.

Stephen V. Byrne
BofA Securities, Research Division

I just wanted to confirm that the margin benefit from propane to propylene that's not realized in the PM&C segment, is that right? And perhaps a question about the headcount reduction, the 2,000 target for the year, what is that off of the total number? And is your benchmarking analysis did it highlight that as an area to focus on like EBITDA per employee or something like that.

James R. Fitterling
Chairman & CEO

Yes. First, Steve, I'm going to take a shot as I want to make sure I get this right. So Howard, I'll ask you to comment. But we transfer propylene and ethylene at market. Having said that, we roll some of the benefit of the propane-to-propylene spread forward into II&I, for example, for polyurethanes and into coatings and monomers. So they see it's there for their integration benefit, and so they see that in their numbers, it rolls forward. So it should show up in that side of the equation.

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On the 2,000 headcount reduction, that is off our published Dow direct headcount list. So you would expect 75% of those exits to happen by the end of second quarter, as Howard said, probably close to 90% by the end of the year. The only reason for the time lag is as some of the site announcements get made on site closures where I have to obviously work through the timing with works councils and others on that and the timing of the closures.

The driving force for that is obviously just looking at our overall cost position and trying to keep our costs lean and in line with demand. If you can take a look at demand really hit in the fourth quarter, really hit the lowest we've seen since the beginning of the COVID pandemic, which was back in March of 2020. And so we really need to tighten up to that level and then see how we can go as we expand out of that. Other thoughts Howard, comments?

Howard I. Ungerleider
President & CFO

No, that's correct. Agreed.

Operator

Your next question will come from the line of Jeff Zekauskas with JPMorgan.

Jeffrey John Zekauskas
JPMorgan Chase & Co, Research Division

ExxonMobil announced a very large project in Baytown to produce ammonia and hydrogen in order to decarbonize their Gulf Coast facilities. Is that something that Dow might do that is do you want to get involved in the ammonia markets or the hydrogen markets in the United States?

And then secondly, for Howard, what's the working capital benefit look like for this year? Is that, I don't know, $400 million? Is it a higher number or a lower number, your cash flows probably will work their way up this year.

James R. Fitterling
Chairman & CEO

Jeff, I'll take the Exxon question and the ammonia question. I'll have Howard tackle the working capital. I think one of the things that's happening is obviously ammonia as a fuel is becoming an interesting market. And so in addition to decarbonizing, there's also a shift in what's expected to be a shift in fuel mix. We've seen that with some announcements in ammonia fuel for overseas shipping. And so I think there's a play into that market.

As we look at our own assets, we're going to look at hydrogen and carbon capture as ways to decarbonize. And obviously, we've got the plan to decarbonize one of our assets with advanced small modular nuclear reactors. It will be site specific as we go through it. I think hydrogen clearly is going to play a role because of the ability to take off gases and through autothermal reforming and convert those into hydrogen. That will probably be the most efficient for us. But there will be a wide variety of uses, but I don't see us entering the ammonia markets.

Howard I. Ungerleider
President & CFO

Yes. Jeff, on the working capital, really proud of the work that the Dow team did. Sequentially, we kept our conversion or efficiency on a day's basis, flat sequentially from Q4 to Q1. You think about as we enter turnaround season as we enter hopefully a period of heavier demand, that's very good. Actually, we put our inventory units down about 2% sequentially.

To your question about the full year, I would say we're working on between 2 and 3 days of structural efficiency, improvement in working capital. On a dollars basis, that's anywhere between $300 million and $500 million for the year in terms of improvement in cash.

Operator

Your next question will come from the line of Mike Sison with Wells Fargo.

Michael Joseph Sison
Wells Fargo Securities, LLC, Research Division

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Nice start to the year. Just curious, I think you mentioned your North American operating rates would improve 2Q to 90%. I think the EBIT driver is up $75 million. So just curious why the improvement in P&SP wouldn't be stronger in 2Q. Are you thinking polyethylene margins are coming down? Or just maybe any other factors that the improvement would have been better.

James R. Fitterling
Chairman & CEO

Michael, I would say 2 things. We've got nominations out for April in terms of pricing. I think there's also capacity coming on. So we're being realistic about where we think things are moving in the marketplace. Exports are up, which is good. We hit the highest level marine pack cargo exports since March of '21. And so that is a really good sign. And the schedule reliability on marine pack cargo exports has been the best since October of 2020. So we're seeing really positive trends there.

The only inventory increase we saw in the region was really at the export hubs, which was sitting there waiting for exports. So I think overall industry inventories are under control. So those are all net positives. Oil to gas spreads promptly are a little bit less than where we ended the quarter. And I would expect as we get into second quarter and demand for that natural gas picks up a little bit. We should see some of that natural gas pricing move up a little bit. But still it's going to be good oil to gas spreads here in the U.S. So I think it's still guiding up on integrated margins, but there could be potential for some upside from there.

Howard I. Ungerleider
President & CFO

Yes, Michael, the other thing is, don't forget, there's a $25 million headwind from a turnaround in Functional Polymers, which is in P&SP as well sequentially.

Operator

Your next question comes from the line of John McNulty with BMO Capital Markets.

John Patrick McNulty
BMO Capital Markets Equity Research

So maybe just to dig a little bit further on the U.S. side of the market, obviously, there is some capacity coming on in the polyethylene area. Can you speak to the demand trends that you're actually seeing if there's any pockets of either strength or incremental weakness that you're seeing? And then also, can you give us kind of an update as to how you're seeing the mix of domestic versus export demand and how you expect that to trend through 2023?

James R. Fitterling
Chairman & CEO

John, the global demand has been improving. North America, we had some benefit, obviously, in the first quarter because the industry had about 14% of capacity online due to force majeures and unplanned events, and there were some delays in capacity startups in the first quarter. We still see North American fundamentals to be very robust as we go into the second quarter and through the year. I think logistics challenges appear to be behind us, both marine pack cargo, road shipments are all kind of getting back to normal space.

The biggest drag right now probably on P&SP is in Europe. Europe has been pretty slow, still some destocking going on there. We're having some advantage from cracking propane in Terneuzen and Tarragona. And so we've been cracking max propane there. So that helps a little bit. But I think the weight of the European market is really the biggest drag right now. I expect North American market to be pretty robust.

Operator

Your next question comes from the line of Kevin McCarthy with Vertical Research Partners.

Kevin William McCarthy
Vertical Research Partners, LLC

Jim, in listening to your prepared remarks, it sounds like you're still evaluating potential for rationalization of some higher cost assets. And so I'm wondering if you could speak to the possible size, scope and timing of that effort, and whether you're really looking at Europe as the center of gravity, given geopolitical and energy changes there or something larger and broader than that.

James R. Fitterling
Chairman & CEO

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Kevin, I would say Europe, obviously has the attention because in most cases, moved into the high cost position around the globe and there's a lot of pressure from higher energy costs as well. LNG costs into Europe right now are in the $14 to $17 a million Btu range, while we sit here in the U.S. between $2 and $3. And so I think you can sense over the long term that, that continues to be the same in the long term, that will put a lot of pressure on the European market.

A lot depends on how the European Union and also how the individual member states respond via energy policies and other changes that they're looking at and hard to anticipate when they'll make those decisions. But energy cost is going to be a big driving force, and that will be one that will be hard to overcome. So we'll continue to look at those assets. We don't want to jump the gun and get ahead of any policy changes that might make them still competitive long term. But those are the biggest things on big assets, big sites that are in our head right now.

Operator

Your next question comes from the line of Duffy Fischer with Goldman Sachs.

Patrick Duffy Fischer
Goldman Sachs Group, Inc., Research Division

Jim, wanted to dig a little bit on the comment you made about a $70 million sequential headwind in chlor-alkali. So a couple of questions there. Is that mostly with the European assets? Or is that on the U.S. contract chlor-alkali you get? And is most of that pain coming from caustic? Or are you also seeing margin squeeze on the chlorine and chlorine derivatives?

James R. Fitterling
Chairman & CEO

Duffy, our exposure on caustic is really Europe and Latin America. So most of that $70 million is on that. None of what was in that guidance, that outlook guidance was related to our contracts with Olin. So nothing related to that.

And I would say that's clearly driven by the market dynamics and the market demand that is driving lower prices and also lower operating rates in those regions. So we'll continue to keep an eye on that. Housing, I think if housing begins to turn a little bit, that will be one of the first things that will help out. And then industrial demand has also been relatively soft. Those two drivers will be the ones that we'll start to make that turn.

Operator

Your next question comes from the line of Josh Spector with UBS.

Joshua David Spector
UBS Investment Bank, Research Division

I just wanted to follow up on volumes I'm thinking maybe another quarter or two out. So the past couple of quarters, your volumes have been down something in the range of 8% to 10% year-over-year. That seems to be kind of where you're guiding for the second quarter. And I mean, generally, we're seeing a slower uptick than what we expected sequentially and some market weakening. So I'm just curious at this point, should we be assuming that volumes are down a similar level to that in 3Q? And obviously, the comps get easier in 4Q. But I'm wondering what in your view would change that trajectory or if that's the right way to think about it?

James R. Fitterling
Chairman & CEO

Yes. Good question on the volumes. I would say North America volumes are coming back, which I think is going to be a real positive. If you look at same quarter last year, I mentioned we were down 11% on volume. That was really led by EMEAI. So EMEAI was down 15% during that same time frame. So you can see that on some of the other cost-advantaged regions, we're still doing relatively well.

The other thing to think about is Asia Pacific. We did start to see after February, we started to see some positive expansion in the China market, which we had not seen earlier in the first quarter. And so if you look at P&SP and II&I, both volumes were down a lot in the first quarter. We had some, as Howard mentioned, nonrecurring licensing activity, which is not really a volume but an EBITDA play. And then we had the Sadara cracker turnaround, which took volumes out as well for them.

And so I think you're going to see Asia Pacific volumes pick up in the second quarter, and I would think that, that would continue. We're starting to see even in areas like MEG, we're starting to see the spot market pick up a bit and the operating rates in China pick up a bit. So that will help -- and then the question will be when do we start to see some positive momentum out of Europe. So I would

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think through the year, we should start to see this gradually improve. And that's what our plan for the year is first half of the year, if you follow where we are, we'll make a little bit less than half of our target for the year, and we'll make the rest in the back half, largely on good price/volume management, good control over operations and our own self-help on delivering that $1 billion of cost saves.

Operator

Your next question comes from the line of Laurence Alexander with Jefferies.

Laurence Alexander
Jefferies LLC, Research Division

Just to follow up on that sequential build. What are you thinking about in terms of the amount of summer inventory build or how to think about the seasonality in Q3 given the mix in the top-end markets you've described?

James R. Fitterling
Chairman & CEO

Well, as Howard mentioned, we're really focused on efficiency. And so we're looking to get 2 to 3 days of efficiency. I'd love to get that efficiency through higher sales rather than through the opposite way. But we're keeping inventories well under control. For example, we ended the first quarter really similar, maybe even slightly lower than we ended the fourth quarter in terms of actual volume and inventory.

I don't think we're in a scenario where there's any reason to really build big inventories going into the season, maybe in a specific business like coatings needs to build a little bit ahead of the seasonal demand. But for the rest, we have the ability to ramp up rates to match that demand, and that's what we're going to do. So I feel like inventory -- we're going to manage it pretty tight through the year. I don't see any outside drivers out there that would give us a signal that we should be doing anything more. We would need to see some really strong demand drivers and demand signals to move off of that tight inventory management.

Operator

Your next question comes from the line of Christopher Parkinson with Mizuho.

Christopher S. Parkinson
Mizuho Securities USA LLC, Research Division

It's obviously been a few years with China now finally emerging from Covid. But can you just kind of give us your latest and greatest thoughts on your 3 main segments regarding the potential for new Chinese supply across polyethylene, MDI, and then just the remainder siloxanes, which you've already been mentioning, just given that they're finally emerging from this, just any update on your thought process there will be incredibly helpful.

James R. Fitterling
Chairman & CEO

Sure. Let me try to do this MDI and siloxanes. Look, on siloxanes, there were about 4 additions in China last year on siloxanes capacity. You had each one of them range, they were between 100,000 and 200,000 tons each. And so -- there are some more planned additions coming throughout this year. But I think the net total -- the biggest year was last year that we saw about 650,000 tons added. So I think we're through that.

MDI, I think, is a timing game, as we've said before, I feel good about where supply/demand is with MDI. In the short term, the operating rates have been between 75% and 80%. And it's all depending on your view of how fast the Chinese capacity is going to come on. We think it's going to be spread out a little bit more over time versus all coming on in 2023. And so our view is that the industry operating rates should hold up in that high 70s, almost 80% range, which historically is a constructive range for MDI.

And in polyethylene, I haven't seen -- as you know, most of the capacity over the last 10 years has been added in China. The supply additions and also the delays and the cancellations mean that things are going to be pretty balanced to maybe even slightly net short over the next couple of years, maybe in the range of 2 million to 5 million tons net short. So I think supply additions in polyethylene is not the big concern right now. I think it's -- we're focused more on growing that recycling business and also making sure that we've got our footprint and the lowest cost to operate jurisdictions. North America, Middle East and U.S. ethane, Canadian ethane, Argentina, all substantially advantaged to European and Asian naphtha right now and even MTO and CTO. So we want to continue to build out our footprint in more cost-advantaged regions going forward.

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Operator

Your next question comes from the line of Mike Leithead with Barclays.

Michael James Leithead
Barclays Bank PLC, Research Division

I was hoping you could help me reconcile Slide 5 and Slide 7 a bit. If we look at Slide 5, your main product verticals look pretty challenged near term. And then on Slide 7, you talk about why they should see pretty attractive growth over the next 1 to 2 years. Obviously, I recognize there's a bit of a time disconnect or differential there. But I guess, internally, how do you get comfortable that what we're seeing near term only transitory or maybe the other way around when do you start rethinking some of the timing of your expansion investments if demand remains weaker for longer?

James R. Fitterling
Chairman & CEO

Yes, good question, Michael. I mean I think a lot right now, a lot of the weight on the market is the inflationary pressure and the things have remained stickier for longer. You are seeing in commodities that pricing is coming down. That hasn't rolled through yet to the consumer. And so the weight on the consumer and the consumers' confidence has not been there. And the manufacturing confidence indexes have not been that great either. A lot of them have been in contraction until just recently, and we're starting to see some positivity in the PMI numbers.

China, just moving positive. It's a little bit mixed still here in North America, but a couple of zones in the Fed are starting to move into positive PMI territory. So I think as that market sentiment improves, we'll get ourselves back on to the normal trajectory. And what typically drives the growth for our products is GDP and an increasing middle class. And both of those, we believe, are going to continue to drive them for the long term.

It's true in Packaging and Specialty Plastics. The drive to urbanization drives a lot of volume in silicones and siloxane. So think about architectural structures, high-rise buildings, even multifamily homes, which have been weak relatively. And then when you get back into II&I, polyurethane and construction chemicals, really driven by housing starts, housing sales, whether it's in insulation or appliances or durable goods and in Dow Industrial Solutions, markets like ag, pharma and excipients, every day, consumer products, household goods, cleaning items that you buy all have positive trends.

So I think it is a timing issue. There's been a lot of projects and incentives and policies deployed to drive this capital that's going to be invested in infrastructure, but it takes a while for that to actually ramp up. And so I think that's why we took the near-term, long-term view of it, and that was what those 2 slides were meant to represent.

Howard I. Ungerleider
President & CFO

And Mike, I mean the other positive on long-term trend of mobility with EVs, don't forget, there's a significant increase in multiple of the need for Dow chemistry in an EV vehicle than in an internal combustion engine. So that will be a real growth driver for our silicones business as well as our elastomers business and, to a lesser extent, urethane acrylics.

Operator

Your next question comes from the line of Aleksey Yefremov with KeyBanc Capital Markets.

Aleksey V. Yefremov
KeyBanc Capital Markets Inc., Research Division

You work on your Alberta project, do you have a sense of how much capital costs have come up roughly since you built the Texas 9 cracker on the Gulf Coast?

James R. Fitterling
Chairman & CEO

Aleksey, thanks for the question. On Alberta, I would think about it this way. Our target there is to try to get the total cost of the project in dollars per ton of capacity to be advantaged to the Texas 9 project. And we believe that we can do that based on what we've seen so far. Through the rest of this year, we'll be getting firm bids on some of the bulk materials that go in, and we'll have a feel for

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that. But we've been watching, obviously, steel, cement and the other markets that really drive a lot of those bulk costs. I think we'll be able to do that.

Part of it is scale. Part of it is learnings on construction and techniques that we picked up off of Texas 9. And so there's some that we'll engineer into this as well. But my sense is this is Texas 9 since start-up, has been well above 15% return on invested capital, which has got to be one of the most successful cracker projects and derivatives projects ever. And I think when you look at Alberta, we're going to have a chance to replicate maybe even improve on that.

Operator

Your next question comes from the line of Arun Viswanathan with RBC Capital Markets.

Arun Shankar Viswanathan
RBC Capital Markets, Research Division

I just had a question about the $1.5 billion Q2 or so implied EBITDA guidance. When you think about that, it looks like there's $75 million of headwinds in there as well. So maybe it's a $1.6 billion number. So how would you characterize that within your framework of peak to trough. Would you still consider maybe $2 billion as a mid-cycle Q2 number. And so maybe you're 75% to 80% of the way there? Or -- and does the cost reductions kind of bridge that gap? Or how are we thinking about where we are kind of in your earnings trajectory?

James R. Fitterling
Chairman & CEO

Howard, do you want to go through the walk through on the outlook?

Howard I. Ungerleider
President & CFO

Yes. No, I think -- I mean, Arun, you're thinking about it right in terms of the walk from Q1 to Q2. I would say my perspective, Jim, you may have your own view. But look, I think $2 billion is light from a normalized basis. We're still looking at that 6 to 12 current portfolio view from trough to peak, and that's heading in the middle of the decade, that should be more like 7.5 or 8 to as much as 13 or eventually 14 once we add in the Alberta project. So I think a more normalized EBITDA for us is in that $9 billion to $10 billion range in a normalized macro.

So when you're looking at $1.5 billion, plus or minus, you're still -- you're right around the floor of the earnings corridor on an annualized basis. And then obviously, that $1 billion cost saves that will ramp, 65% that will get us will come to the bottom line in the second half of the year, that just -- is there to protect and ensure that we can deliver in that $6 billion plus or minus range.

Operator

Your next question comes from the line of Patrick Cunningham with Citi.

Patrick David Cunningham
Citigroup Inc., Research Division

In the release, you highlighted some year-over-year strength in functional polymers for renewable technology. Can you highlight some of those technologies? And then similarly, on the near-term growth investments. I think Functional Polymers is a significant part of that. What technologies or end markets are targeted investments here?

James R. Fitterling
Chairman & CEO

Yes. Welcome, Patrick. And Functional Polymers is about 25% of the P&SP portfolio on the polymer side. And I'd say the two biggest areas of strength there are in the solar photovoltaic films when you think about the protective films that are used to put together the solar panels. We've got a good position there. And with some of the leading producers around the world and we're starting to see some real volumes pick up there. So I think you're going to see that industry be the beneficiary in the near term, probably one of the early beneficiaries of the infrastructure and the IRA monies that have been deployed.

And the other area would be wire and cable, and we're starting to see a pickup there. So as we put more alternative energy in and we also have to deal with the aging grid and we have to deal with also infrastructure work that utilities need to do on the grid to increase the reliability and expand the grid because populations are expanding in a lot of these urban areas. That drives demand for wire and

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cable products of which we have a leading market position, whether it's high voltage transmission or whether it's down into medium and lower voltage, things like in the telecom sector. So as we're expanding reach for more wireless access to people, we're going to see more telecommunication towers go up, that's going to drive more demand for wire and cable products for those projects.

Operator

Your next question comes from the line of Matthew Blair with Tudor, Pickering, Holt.

Matthew Robert Lovseth Blair
Tudor, Pickering, Holt & Co. Securities, LLC, Research Division

Jim, could you provide some more color on your auto end market. The mobility category on Slide 5 actually looks a little bit better than all of your other major areas. Are you gaining share? And how are things tracking relative to your expectations?

James R. Fitterling
Chairman & CEO

Mobility is a growth platform for us, and the team there that's focused on building back some of that core capability that we had prior to the spin is doing a great job. Silicones are a big part of that. So improving the resilience of the system with more electronics on the vehicles is great. But we also play a leading part in noise, vibration and harshness in the vehicle. So we've got a long history of doing that. We're starting to see pickup for recycled materials. So our SPECFLEX C and also our RENUVA recycled materials, think recycled mattresses, SPECFLEX C PU system is made out of polyols made out of recycled engine oil are boosting pickup in automotive seating applications.

We also have a lot going on with acrylic, both hybrid acrylic and silicone technologies in this area. We've just won some recent innovation awards for some products that I think are going to be real platform winners. LUXSENSE silicone leather. We just got a big innovation award. This is a really high-quality synthetic silicone-based leather which can be used in automotive applications. It's durable. It holds color well, you can clean it easily.

Also a lot of pickup with the Bridgestone self-sealing tires, which has a silicone inner layer to it, which allows that tire to seal. And that will completely eliminate the need for a spare on a vehicle. That also can be recycled. The silicone can be separated from the tire and be recycled. And then we play in the lighting area. In LED lighting, we're a big provider both in what you would see in your home every day with LED lighting, but also in multiple optical silicones, think the headlamps in automotive applications as they become more sophisticated, they move more to the multiple optical silicone in those applications. So we're excited about it. We think it has a potential to be a significant contributor to our future growth.

Operator

I will now turn the conference back over to Pankaj for any closing remarks.

Pankaj Gupta
Vice President of Investor Relations

And thank you, everyone, for joining our call, and we appreciate your interest in Dow. For your reference, a copy of our transcript will be posted on our website within approximately 48 hours. This concludes our call. Thank you, once again.

Operator
Ladies and gentlemen, thank you all for joining. You may now disconnect.

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