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Published December 8, 2014

Last week, Dow Chemical Company (DOW) moved closer toward their goal of divesting some of their lower-margin units via asset sales when they agreed to sell their sodium borohydride business and a polyolefin films plant in Ohio for about $225 million. These sales to Vertellus Specialty Materials LLC and Valfilm North American Inc., respectively, come on the heels of Dow's recent sale of Angus Chemical Company to private equity firm Golden Gate Capital for $1.22 billion last month.

Even before Friday's announcement, the company indicated back in November that it was on track to meet its earlier asset sale target of $4.5 billion to $6 billion by the end of 2015. At the same time, Chairman and CEO Andrew Liveris also raised this target to between $7 billion and $8.5 billion in asset sales by mid-2016.

INCREASED SHAREHOLDER ACTIVISM:

Part of the motivation to sell off some of Dow's assets has come from activist investor Daniel Loeb, founder of hedge fund Third Point, who has urged the company to split off its petrochemicals business from segments that make specialty chemicals. Loeb has also criticized Dow for failing to meet financial targets, while calling for greater financial transparency among the company's operating segments to better understand where value is lost.

So far, the company has acquiesced to Loeb's demands as evidenced by the aforementioned asset sales, the addition of four new independent directors to Dow's Board, and their recent move to change how they report results from some of their business segments. For example, Dow's feedstocks and energy segment will now become part of their performance-plastics segment because the segment produces ethylene, which is used to make plastic.

Dow is not the only company that has faced increased shareholder scrutiny lately. In fact, it is not even the only company under fire from activists within the chemicals industry. Nelson Peltz, founder of Trian Fund Management, has been pressuring DuPont (DD) to break itself up into a growth company that would include agriculture and biosciences units, and a cyclical company of businesses that require less investment.

In recent years, activist investors have been targeting more and larger companies, according to a March 2014 report from McKinsey & Company. Their analysis found that activists targeted US-listed companies with an average market capitalization of $10 billion – an increase from the $8 billion average in the prior year and a sharp increase from the less than $2 billion average at the end of the last decade. Further, in each of the past three years, activists have launched an average of 240 campaigns, which is more than double the number a decade ago.

A similar trend was found in a survey done by Ernst & Young earlier this year as well. In it, they found that more than 90% of global companies now say that the boardroom agenda is heavily influenced by shareholder pressure. Given Loeb's push for new independent directors on Dow's Board, as well as other similar actions by prominent activists such as Carl Icahn and Bill Ackman, there is certainly some truth to EY's findings.

So why has shareholder activism increased so much in recent years? John J. Madden of Shearman & Sterling LLP cites various factors such as the enactment of the Sarbanes-Oxley Act in 2002 following the bursting of the dot-com bubble (aka TMT bubble) and the uncovering of major frauds at Enron, WorldCom, and others. Later on in the decade, Madden cites excessive executive compensation and the Dodd-Frank Act as catalysts for increased activism.

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A MORE FOCUSED AND SHAREHOLDER-FRIENDLY COMPANY:

Whether the result of increased shareholder activism or not, overall, Dow has made strides in strengthening their operations while adding shareholder value. Aside from the recent moves taken by Dow to meet Loeb's demands, the company has also taken several measures to increase shareholder value. Specifically, the company increased their dividend by 14% to 42 cents per share (quarterly) while also raising their stock buyback program by $5 billion to $9.5 billion. Both of these actions are undoubtedly positive for current and future shareholders.

Meanwhile, as Dow has focused more on their specialty chemicals business, their financials have improved somewhat in recent years given the greater pricing power that exists among companies within the industry. This ultimately translates into higher margins and increased profitability.

For example, over the past several years, gross margins have grown from under 10% in 2008 to almost 17% in 2013. Further, in the quarter ending September 30, 2014, gross margins came in at 18.3%, helped by higher selling prices, increased sales volume, and higher operating rates. What's more, EBIT and net profit margins have both shown improvement in 2013 and throughout much of 2014.

Despite the recent increase in long-term debt – which currently stands at approximately $19 billion as of September 30, 2014 – Dow's debt to equity ratio (D/E) is in line with the industry average of 0.9 and has held steady over the past decade around that number. Additionally, Dow's financial leverage has decreased over the past several years as well by approximately 25%, according to Morningstar. Further, after some deterioration during the financial crisis, Dow's interest coverage ratio improved in 2013 and has continued to improve in 2014.

Finally, on a valuation basis, shares of DOW look slightly undervalued compared to its competitors, and fairly valued on most metrics compared to its longer-term averages. However, based on Dow's current price-to-earnings ratio (P/E) of 16.7, shares are significantly undervalued relative to its 10-year average around 29. Moreover, at Friday's closing price of $50.16, shares of DOW yield roughly 3.4% – approximately 100 bps more than the industry average. Therefore, given current valuation levels and the margin of safety (due to the dividend), it would appear as though shares have additional room to run before valuations become stretched.

BOTTOM LINE:

In general, companies that have been the focus of increased shareholder activism have been found to exhibit better price performance (higher share prices) and operational efficiency over the five-year period following activist intervention. Therefore, Third Point's recent interventions in Dow Chemical, combined with recent asset sales and shareholder-friendly actions (see: stock buybacks and increased dividends), should all help boost shares of Dow Chemical going forward.

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