

Major Diversified Chemicals

Overview: This edition of the **MRQ** will focus on quality of earnings prospects for the deeply cyclical chemical industry. For the diversified *chem.* manufacturers, recessionary pressures have slapped the cuffs of restructuring with a vengeance.

Yet, there are some encouraging signs these cost-cutting efforts are bearing fruit with respect to the bottom line. The question is, **when** will top-line growth return and **which** of the major diversified producers will benefit most?

From a macro perspective, the industry faces strong headwinds going forward; uncertain domestic demand and new capacity coming online from Asia and the Middle East.

Yet, we also see tremendous opportunity for the well managed and integrated producers who can tap into lower cost feedstock sources and provide innovative products and services which embrace sustainability and forge into more eco-friendly “green” philosophies while addressing the integrated and complex global markets these companies serve.

Companies Reviewed in this edition

Dow Chemical (DOW)

DuPont (DD)

FMC Corp. (FMC)

Eastman Chemicals (ENR)

Dual Cash-Flow Signals:

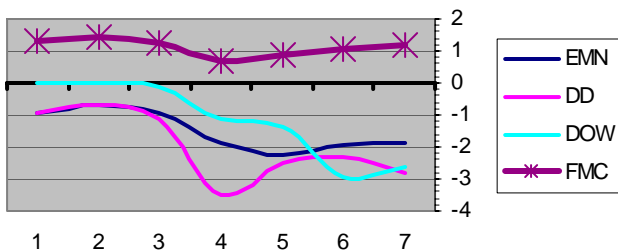
Confirmed Bearish
Recent Bullish

DOW, EMN and FMC display Recent Bullish / Confirmed Bearish

Recent Bearish
Confirmed Bearish

DD displays Recent Bearish / Confirmed Bearish indicators.

Dual Cash-Flow Figures (7 qtrs.)



FMC displays the strongest dual-cash trend of our study group. Dual-cash figures have remained positive throughout the seven periods reviewed, increasing in each of the previous 3 qtrs.

DD reveals the weakest overall dual-cash figures, while **DOW** displays the most deteriorating trend during the review period.

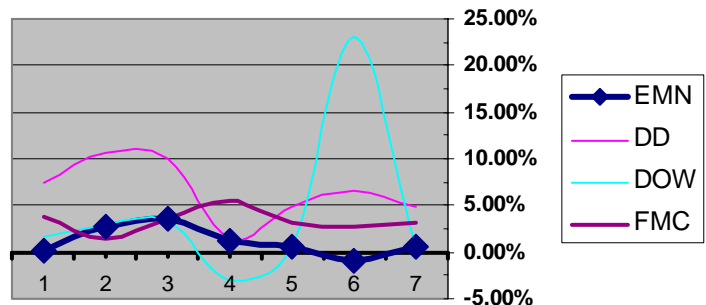
Dual-cash trends at **EMN** show stabilization over the past few periods, but D-C-F figures remain in negative territory.

Accrual Ratios: According to our model, an accrual ratio of -5 or less is very bullish and a ratio of $+5$ or more is very bearish.

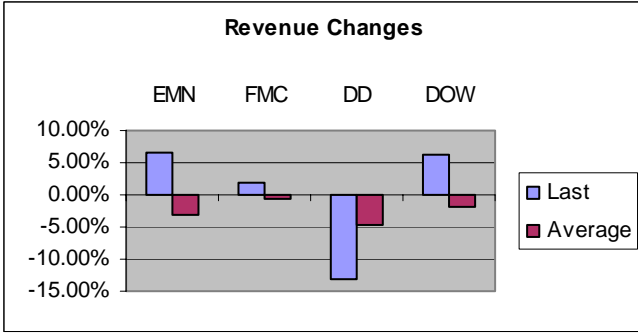
Although none of these companies display extreme bullish accrual readings, **EMN** (Neutral) displays the lowest (best) accrual trend of the group. **FMC** (Neutral) displays the next lowest accrual trend.

DD (Bearish) shows the highest (worse) accrual trend, while **DOW** (Neutral) has produced the most inconsistent readings throughout the periods reviewed.

MR Accrual Ratios



Financial Statements



Revenues: EMN and DOW posted sales growth of 6+ % in their latest periods (qtr.-to-qtr.).

FMC increased sales a modest 1.6% while revenues at DD fell -13.1% in their most recent periods.

Average sales during the review period (7 qtrs.) declined for all companies.

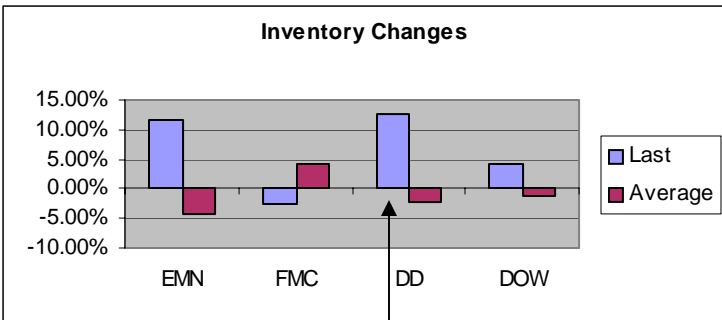
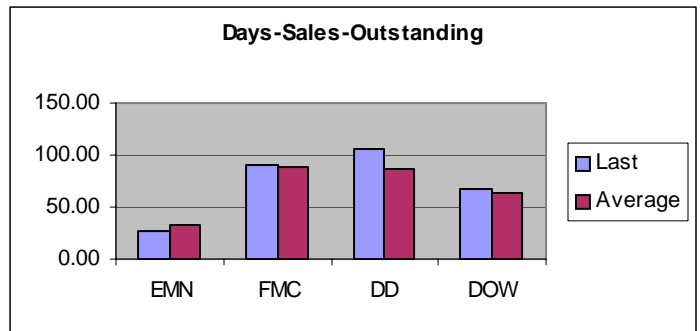
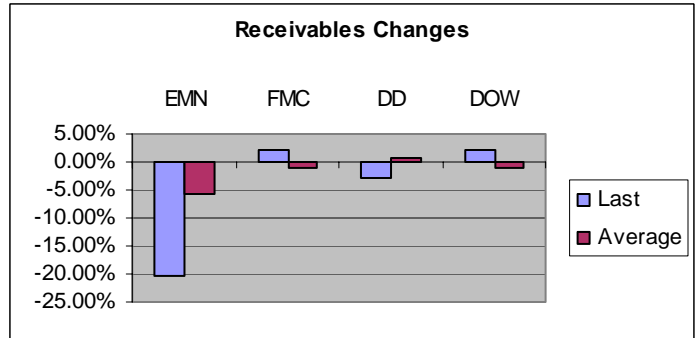
Accounts Receivable: There are noticeable contrasts between AR and DSO changes within our study group.

EMN posted -20.5% decline in AR for its latest period. D-S-O's for the same quarter fell to 26 days from an average of 31 days.

Note: EMN's low DSO figure is the result of an accounts receivable program started in 1999. It allows EMN to sell certain trade receivables on a non-recourse basis to a consolidated special purpose entity which in turn may sell interests in those receivables to a third party purchaser which generally funds its purchases via the issuance of commercial paper backed by the receivables interests.

In contrast, the decline of receivables in DD's latest quarter resulted in the highest DSO figure of our group (105 days), well above its average of 86 days.

Receivables grew modestly for FMC and DOW in their latest periods and DSO's edged slightly higher compared to their averages.



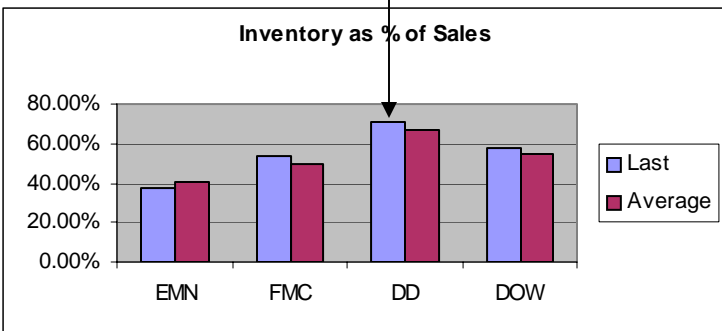
Inventory: A key issue for the integrated producers is raw material costs. Feedstock prices remain volatile and the industry continues to be challenged by slackened demand and low volume pricing issues.

EMN saw inventory levels climb 11.74% in its most recent period, while inventory as a % of sales declined slightly compared to its average.

FMC posted an inventory decline of -2.51% in its latest quarter. Inventory as a % of sales however, rose to 53% vs. its average of 49%.

DD displays the biggest jump in inventory growth and the highest level of inventory to sales in its latest quarter. We do note that these increases came on a -13% drop in sales for the same period.

DOW saw levels rise 4.28% in latest, but in-line with revenues.

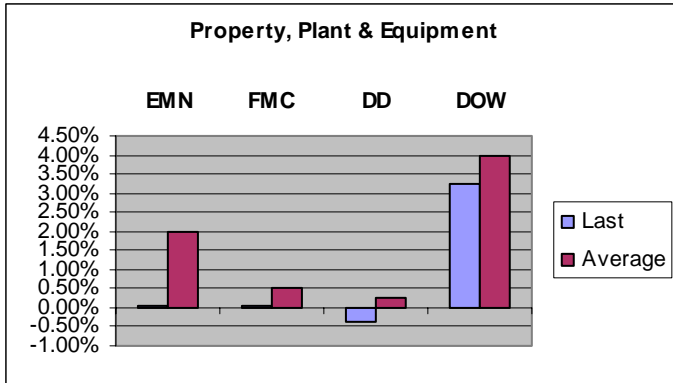


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Property, Plant & Equipment: As you can see in the graph below, PP&E levels for all companies in our study group have declined in the most recent period and are well below the average PP&E change during the previous 7 quarters.



These declines are the result of industry wide plant closures, divestitures and previous projects put on hold as the global recession intensified.

DD is the only company in our review group to post a negative PP&E change (-0.40%). PP&E changes for **EMN** and **FMC** were negligible.

In contrast, **DOW** displays the highest recent (+3.22%) and average (+3.99%) change in P,P&E growth, due primarily to the acquisition of *Rohm & Haas* last year.

Accounts Payable: When it comes to preserving cash-flow, stretching accounts payables has been the lever of choice with many industries during the current slow-down. For the diversified chemical manufacturers, “pushing” payables have been critical to preserving operating cash-flows.

Three of the four stocks in our review group (**EMN, DD and FMC**), posted AP growth > sales during their latest periods.

EMN's AP jump was 2.55 times > sales, while **DD**'s 16.89% AP growth comes on a -13.1% decline in sales.

	AP Growth	Sales Growth
EMN	17.14%	6.7%
DD	16.89%	-13.1%
FMC	6.59%	1.86%
DOW	5.03%	6.39%

Revenue Metrics

Research & Development: After several years of significant increases, R&D spending by the major chemical companies was largely flat in 2009. According to survey data released last year by the Industrial Research Institute, R&D spending by chemical companies was expected to lag behind food and petroleum companies throughout 2009. Another survey by industry publication Chemical and Engineering News found that six major U.S. chemical companies were planning to cut R&D spending by 1.8% in 2009.

Revenue Metrics (Lowest as % of Sales)

Research & Development: **Eastman Chemical**

Cost-of-Sales: **FMC Corp.**

S/G/A: **DOW Chemical**

Payables: **Du Pont**

R&D spending (as % of revenues) for our study group, averaged 3.62% in their latest periods. Surprisingly, this represents a modest improvement over the 3.18% avg. of our study group during the seven prior quarters.

EMN reported the lowest R&D-to-sales of 2.7% while **DD** spent 5.44% of sales on R&D in its latest period.

Cost-of-Sales: Three companies in our study group (**DD, DOW and EMN**) displayed lower C-O-S in their most recent periods as compared to an average for the seven quarters reviewed. **FMC** produced the lowest C-O-S metric in its latest qtr., but it was the only company in our group to post an increase as compared to its seven quarter average.

Selling, General & Admin. Expenses: All **four** companies in our review group displayed rising SG&A expenses in their most recent periods as compared to their seven quarter averages. Of the four companies, **DOW** displays the lowest SG&A-to-sales in its most recent quarter while **DD** displays the highest.

Payables: **DOW** was the only company in our group to display an improvement in recent quarter payables-to-sales as compared to its seven period average. While **DD** shows the lowest overall payables-to-sales figure, it has deteriorated the most in comparison to its seven period average. **FMC** posted a payables-to-sales figure of 90.47% in its latest qtr., the highest of our group..

Capital Productivity

Three of the four companies in our study group (**DD, DOW and FMC**) each experienced declines in **all** capital productivity categories in their most recent quarters as compared to the average of their prior seven periods.

In contrast, **EMN** displayed improvement in three of four categories.

Capital Productivity (Lowest per each \$ of Sales):

Inventory / Revenues: **Eastman Chemical**

Receivables / Revenues: **Eastman Chemical**

Inventory & Receivables / Revenues: **Eastman Chemical**

P,P&E / Revenues: **FMC Corp.**

Not surprisingly, all **four** of our study group companies realized significant declines in P,P&E / Revenues. In the most recent period, capacity utilization costs per-dollar-of-sales averaged \$1.76. This is 17.33% higher than the \$1.50 average for the seven quarters reviewed. The increase is largely due to the combination of lower capacity throughput and the consequence of higher unit costs resulting from falling demand and low volume orders by customers across many product categories.

Summary Analysis

Merriam Report© Score

	EMN	FMC	DD	DOW
Balance Sheet and Income Statement	4	-2	-6	-6
Accrual Ratios	-0.25	-0.6	-1	-0.25
Revenue Metrics and Capital Productivity	0	-6	-4	-2
Goodwill Trends	-0.75	-0.5	-2	-1.5
Merriam Report Totals	3	-9.1	-13	-9.75

Best Earnings Quality: Eastman Chemical (B-), FMC Corp. (C+)

Worst Earnings Quality: Dow Chemical (C-), DuPont (C-)

Eastman Chemical (EMN): HOLD / BUY on Pullback - Merriam Report Score = +3. Company operates in five segments: Coatings, Adhesives, Specialty Polymers and Inks. We anticipate an improving environment for acetate tow and triacetin plasticizers (used in cigarette filters) as well as Performance Chemicals and Intermediates (diketine derivatives, ketones and anhydrides) for pharmaceutical, fiber and food and beverage products.

Current Price: \$60.22; Estimated Fair Value: \$50.28. Trading Range is \$59.70 to \$61.80. Partial positions may be considered on any pull-back to the \$55 area. Full positions can be considered up to \$50.

FMC Corp. (FMC): AVOID / BUY on Pullback - Merriam Report Score = -9.1. Company operates in three primary segments: agricultural products, specialty chemicals and industrial chemicals. We believe their diversified crop protection products will maintain market leadership and we note that FMC is considered to be the third largest supplier of lithium, used in everything from pharmaceuticals, polymers, to **batteries** and lubricants.

Current Price: \$53.15; Estimated Fair Value: \$47.49. Trading Range is \$50 to \$57. Partial positions should be considered on any pull-back to the \$50 area. Full positions can be considered up to \$47.

Dow Chemical (DOW): AVOID / Possible Short - Merriam Report Score = -9.75. Company operates in six segments: performance plastics, performance chemicals, agricultural sciences, basic plastics/chemicals and hydrocarbons/energy. We believe there is great promise for the Dow Agricultural Sciences unit, particularly with their advances in zinc finger DNA-binding protein (ZFP) technology for the development of products in plants and plant cell cultures. However, we also believe there will be more asset write downs associated with the company's purchase of Rhom & Haas last year.

Current price: \$29.83; Estimated Fair-Value: \$22.15. Trading Range is \$26 to \$31. Partial positions should be considered on any pull-back to the \$24.50 area. Full positions up to \$22.

Merriam Reports for companies mentioned are included with this newsletter.

E.I. DuPont de Nemours (DD): AVOID / Possible Short - Merriam Report Score = **-13** . Company operates in five segments: agriculture and nutrition, coatings and color technologies, electronic and communication technologies, performance materials and safety and protection. While we believe the company's focus on sustainability and eco friendly technologies will be the driver for future profit growth, DD's balance-sheet in our view is the weakest of the four companies mentioned in this newsletter.

Current price: \$33.96; Estimated Fair-Value: \$27.06. Trading Range is \$31 to \$35. Partial positions may be considered on any pull-back to the \$30 area. Patient investors however, may want to wait for the \$27 area before considering full positions.

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