THE DOW CHEMICAL COMPANY

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1985 ANNUAL REPORT

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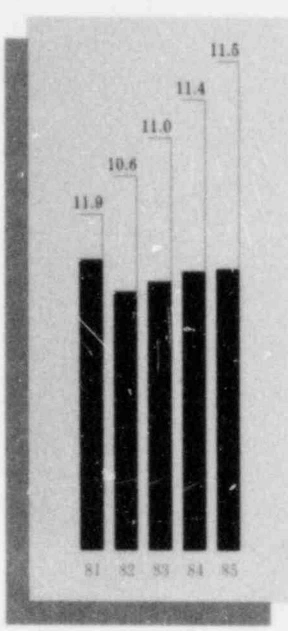
1985 ANNUAL REPORT

HIGHLIGHTS OF THE YEAR

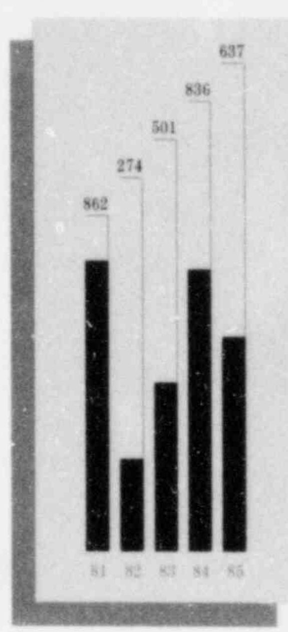
(in millions unless otherwise stated)	1985	1984 Restated	% Change
Net sales	$11,537	$11,418	+ 1
Operating income	637	836	− 24
Net income	58†	560*	− 90
Net income per share (in dollars)	.31†	2.89*	− 89
Dividends paid per share (in dollars)	1.80	1.80	0
Stockholders' equity (at year-end)	4,792	5,040	− 5
Capital expenditures	806	781	+ 3
Depreciation	977	908	+ 8
Research and development expenditures	547	507	+ 8
Total taxes	270	396	− 32
Wages, salaries and benefits	2,050	1,930	+ 6
Employees (in thousands, at year-end)	53.2	49.8	+ 7
Average shares outstanding	190	194	− 2

**Includes extraordinary income.*
†Net income was reduced by a $592 million pretax special charge against 1985 earnings.

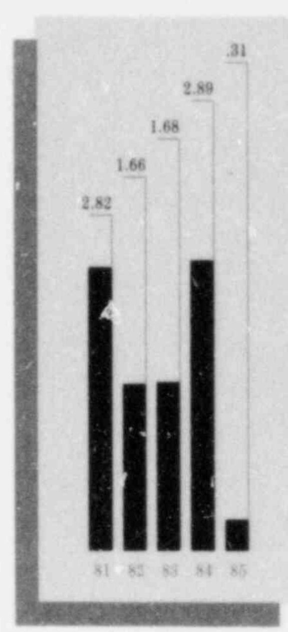
Sales
($ in billions)



Operating Income
($ in millions)



Earnings Per Share
(in dollars)



To Our Stockholders

1985 – a year of many accomplishments, a year of major frustrations. How can a year have so many peaks and valleys? Let me explain.

A lot of things went right in '85, but this was in great part obscured by the fact that a handful of our basic businesses suffered very badly. The arithmetic is simple: five basic products of which we sell a total of 19 billion pounds per year dropped in price an average of five cents per pound – that's $500 million of profit down the drain. This major shortfall tends to obscure the good things that happened, and there are a great many which deserve comment.

- Our safety record was the best in history and one of the best of any company in the world in any business.
- The pharmaceutical business sharply increased its profitability and had a very successful U.S. introduction of Seldane, Merrell Dow's unique non-sedating antihistamine.
- Our consumer products business had a record year with the Dow consumer business and Texize both making important contributions.
- The urethanes business had a good year and the acquisition of the Upjohn polymer chemicals business strengthened its performance.
- Our relatively small separation systems business was enhanced by the acquisition of FilmTec. We believe that there is an excellent future in this field.
- Europe had another excellent year and was again the most profitable geographic area in the Company.
- Our emphasis on quality continued to bear fruit, and we remain determined to be the best at whatever we do.
- Our legal department achieved some notable victories in 1985. This is particularly important in view of the ever-rising tide of litigation in the United States.
- Our R&D effort continued to pay off. Dow inventors received 1,538 patents around the world and applied for 2,899 more, both all-time records.
- Our financial people turned in another superb performance and, in a difficult environment, managed to produce yet another exchange gain.

As we go into 1986, we have several important external factors working in our favor.

- Starting in the summer of '85, the dollar finally began to weaken against major foreign currencies and this will improve the competitive position of U.S. industry.
- Interest rates have been trending downward and will reduce our interest expense for the foreseeable future.
- The prices for large-volume plastics are steadily improving after a long downward spiral.
- The cost of our raw materials is stable to down and the supply appears to be ample.

I am not saying that there aren't any clouds on our horizon, because there are. But it is good to have some solid, positive factors going into a new year. Of the potentially negative influences, I would highlight the potential effects of our litigious society. The tort laws of this country are sharply increasing the costs of operating a business in the U.S., and obtaining satisfactory insurance coverage at a reasonable price has become a serious problem. This is one area where I believe legislation will be necessary to bring back some sanity in the litigation explosion.

Near the end of the year, we determined that the lack of recovery in some of our basic businesses required that we take certain write-downs and write-offs of facilities and that we reduce the total staffing of the Company. As a result of this, we took a $592 million write-down and saw 2,700 employees leave the Company principally through a voluntary retirement incentive program. The result is a leaner company, better structured to face the challenges of the future.

As we go to press, Bob Lundeen has announced that he will not stand for reelection as chairman of the board since he will reach Dow's mandatory retirement age in June. The board has indicated that they intend appointing me to the additional post as chairman of the board following the May stockholders meeting. I will retain my responsibilities as president and chief executive officer. I gladly accepted this additional responsibility, particularly since I will be turning over the jobs of president and CEO before the end of 1987. As that time approaches, I feel very good about the wealth of excellent people in Dow's ranks and our ability to have a smooth transition in the top management.

In the fall, we launched a major public affairs campaign to increase public awareness of the many contributions Dow makes to a better society. We felt that this was necessary, particularly because our employees were constantly telling us, "The media seems to carry only bad things about us. Why don't we talk more about the good things we do?" We hope this "Dow lets you do great things" campaign will succeed in creating a better understanding of our activities and contributions.

At a recent management meeting, we reaffirmed the principles that guide your company, and we summarized these in a statement of core values that you can find below. We live by this code, and will work hard to continue to make you proud of being one of the owners of this Company.

Paul F. Oreffice
President and Chief Executive Officer
Midland, Michigan

February 11, 1986

Dow Core Values

Long-term profit growth is essential to ensure the prosperity and well-being of Dow employees, stockholders and customers. How we achieve this objective is as important as the objective itself. Fundamental to our success are the core values we believe in and practice.

Employees are the source of Dow's success. We treat them with respect, promote teamwork, and encourage personal freedom and growth. Excellence in performance is sought and rewarded.

Customers receive our strongest possible commitment to meet their needs with high-quality products and superior service.

Our *Products* are based on continuing excellence and innovation in chemistry-related sciences and technology.

Our *Conduct* demonstrates a deep concern for ethics, citizenship, safety, health and the environment.

The Dow Chemical Company is in one of the most dynamic periods in its history, for rarely has the global competitive environment for chemicals experienced such transition.

Increased participation by hydrocarbon-rich countries is creating new supply patterns for chemicals and plastics and a reordering of global competitors. Technological advancements are changing historical production and geographic relationships.

Change is also creating many new opportunities. Industrialization and urbanization in less-developed countries now call for chemically related materials and processes to produce finished products and reduce pollution. Increased food production is a high priority with most nations. Virtually everywhere there are more calls for pharmaceuticals of all types while worldwide demand for consumer conveniences continues to rise and become more homogeneous.

Important to Dow in this environment is *maximizing growth and maintaining leadership by realizing the best emerging opportunities.*

That was the focal point of the most important event in 1985 for the future of The Dow Chemical Company. In September, Dow's operating committee convened a cross section of key managers to review the Company's fundamental strategic direction and address planning refinements needed to "enable Dow to reach the end of this century as a great, growing and profitable company," as Dow president and chief executive officer Paul F. Oreffice said to attendees. Here is a synopsis of their discussions and operating committee comments on each major element.

Emphasis on Specialties

To attain superior growth in earnings per share and return on equity, Dow's strategic objective will continue to be: to grow and diversify through emphasis on specialty chemicals and services while maintaining great strength in basic chemicals and plastics. The Company will concentrate on products and services in chemistry-related technologies.

Six major priorities will be applied to each business:

- continuous improvement in the quality of Dow products and services;
- maintenance of the earning power of existing strong assets. Divestiture and de-emphasis of some products and businesses will occur where necessary;
- continuous reduction of costs through efficiency and good management;
- selective acquisitions as an added basis for further growth and diversification;
- effective administration, with a focus on productivity, not bureaucracy;
- safety in every aspect and protection of the environment.

Chaired by Paul F. Oreffice, the operating committee comprises:

All are members of Dow's board of directors.

Hunter W. Henry, executive vice president and president, Dow U.S.A., responsible for Dow's largest operating area;

Robert M. Keil, executive vice president responsible for the Company's financial activities as well as its global agricultural chemicals and consumer products businesses;

Keith R. McKennon, group vice president and director of research and development. He is also responsible for Dow's legal department and government and public affairs;

Business Priority:
Refine and Rebalance

We will continue to strive to optimize profitability in Dow's basic chemicals, basic plastics, industrial specialties and consumer specialties segments.

Basic chemicals and basic plastics will receive resources consistent with their ability to contribute to the Company's profit. Especially, Dow's technological leadership will be maintained in those businesses. Decisions to add significant new capacity in this segment will be based on market requirements rather than on perceived future demand.

At the same time, we will continue to apply resources to industrial and consumer specialty products that generate high returns from our investments.

"Basic chemicals and basic plastics represent an indispensable base for diversifying into a wide range of downstream product opportunities. The steps we've taken in the last few years to rebalance capacity requirements in basic chemicals have helped greatly to assure its cash-generating ability. Those actions were critical to maintaining this segment's support role for diversification. Conditions change of course. And should the need arise to further reduce capacities in these segments, we're prepared to proceed appropriately. Dow must remain among the lowest-cost manufacturers in all products of strategic importance."

"Those products in Dow's industrial specialties segment that will contribute to future profitability deserve full support. But clearly, we need to regularly re-evaluate the contribution of individual products. Some have not shown acceptable growth. Some may over time become a poor fit with our strategic direction. Our focus should be on reshaping our commercial activity in these products to more closely match new opportunities. As a result, profits will be restored to previous levels then improve further, since they'll have a much stronger foundation."

"Growth in Dow's agricultural chemicals, human health and household products businesses should be nurtured with the full slate of resources they need to achieve their global growth potential. 1985 was the year consumer specialties as a group began living up to its promise of bottom-line results. They are well on their way to providing the superior growth, recession resistance and the high returns we expect from quality investments."

"Dow has been highly successful in managing the international financial aspects of its businesses. Our expertise in foreign currency management has been instrumental in transforming the potentially negative effects of fluctuating currency values into a positive contribution to our activities around the world. And the creative use of foreign-based debt instruments has helped considerably to balance overall financial risk. Both elements are key to Dow's continued success in preserving financial flexibility and strength. But the heart of that activity will be ensuring that capital spending, investment programs, dividend policy and levels of indebtedness relate to the levels of internally generated funds and the equity base."

"In the final analysis, we are here to serve our stockholders. And while we must reach the result in different ways, the measure that counts most at the end of the tally is return on stockholders' equity. That will be our principal measure of performance."

Frank P. Popoff, executive vice president responsible for Dow's five geographic areas outside the United States, employee relations and manufacturing and engineering;

Joseph G. Temple, Jr., executive vice president and president of Dow's human health subsidiary, Merrell Dow Pharmaceuticals Inc. He is also responsible for global product planning and management through the corporate product department.

Personnel Priority:
Maintain Great Depth in People

We will continue to recruit high-quality individuals and maintain a work environment that stimulates rapid personal and professional growth. Compensation programs will properly reward performance and recognize that different incentives may be required to realize optimum results in different segments of Dow's business.

"Innovation in Dow's organization is as important to growth as any innovation made in research and development or elsewhere in the Company. Continual renewal through recruitment of quality people – people with good training and bright ideas – is key to maintaining great depth in skill and talent. One of the secrets to recruiting effectively is making sure some of the best people in the Company are out finding and hiring the best people they can. That approach has worked very well for Dow. We've found that, put simply, first-class talent likes to associate with first-class talent."

"Let's not forget that strategies are created and implemented by decision-makers throughout the organization. In other words, decision-makers and decision-making ability are the real key to growth for Dow Chemical. Early challenge and responsibility are important to their development process, as is exposure to the different facets of Dow through a variety of job assignments. Without question, we have the experience and all the tools we need to ensure that Dow retains its reputation for quality management. The challenge will be to use those elements with the increased effectiveness the market will demand of this Company."

"As Dow becomes more diverse, we'll have to ensure that we continue to compensate people well and fairly and in ways that they find particularly rewarding, ways that are consistent with the experience of their peers in an industry. It only makes sense to ensure that our compensation practices reflect the normal practices for an individual business."

Research and Development Priority:
Manage on a Global Scale

Continuous development of new products and services is the essence of competitive advantage for Dow Chemical.

Emphasis will be appropriately balanced between new product development and pure research. The budgeting of research expense and capital will be integrated with global product strategies. Increased attention will be placed on coordinating global research and technology management so that new developments can be moved worldwide more efficiently and quickly.

"Our commitment to research is designed to create many more opportunities than we will ever have resources to completely develop. On the new business development front, for instance, we've decided to pursue emerging opportunities in membrane separation technology, engineering thermoplastics and engineering ceramics, to cite three of the most attractive areas. The point is, we can spend our money on research and development, on other discretionary resources, on capital projects or on acquisitions. But we can never have enough money and good people at the same time to pursue all opportunities. We must set priorities. Our performance will be graded on how well and how creatively we strike the optimum balance."

"Research productivity in Dow continues to rise. We have commercialized more products in the last two years than in any similar period in our history. So planning and deploying research resources on a truly global scale at this juncture make a great deal of sense for Dow. It will result in greater flexibility in research and the highest possible efficiency in matching research resources with the best emerging opportunities."

"The professional relationships that characterized past success in new product development will be greatly enhanced by the integration of diverse technical disciplines. Chemists, for example, are finding that, while they must continue to work closely with physicists, electrical engineers or molecular biologists, they must also spend more time in the customer's shop, dealing directly with his problems and opportunities. That trend is only going to accelerate. And so it should. It is a highly positive trend, one that will lead to some very intriguing new products."

Organization Priority:
Remain Flexible and Evolutionary

Dow has evolved since the 1950s from a simple single national, fully functional organization to a complex multinational, three-dimensional matrix organization. The total change has been enormous, but employees have remained very effective and have adapted well because the organization has evolved in harmony with the Company's strategic direction.

Our objective has been, and will continue to be, to organize to the skills and strengths of people, not to a format, and to remain flexible in our approaches.

In addition, Dow's strategic direction will be implemented on a global basis according to business-specific plans which have at their center two key principles:

- geographic and functional strengths will be maintained;
- planning and management on a global scale will receive increased attention.

"Build the organization needed without creating a vast bureaucracy. Is that possible? Certainly, by deliberately tilting staff balances toward 'doers' and away from 'helpers'. More salespeople rather than order processing staff. More product discoverers, fewer administrators. More entrepreneurs and fewer analysts."

"Dow is widely recognized as being among the most international of all global chemical companies, perhaps unique in that we have an effective presence in so many locations in the world. Our geographical strength is pivotal to our success in global product management and our ability to capture opportunities in the Pacific Basin countries and China, to name two areas of interest. But in no way does a global approach to managing our organization and businesses mean centralization."

"By whatever means we can muster, we must avoid the artificial and psychological barriers to maintaining a highly adaptive organization, which can arise as an organization grows and diversifies. And wherever we find them in Dow, we'll seek to tear them down."

"Successful development of specialties has demanded a strong 'outside-in' orientation and considerable flexibility. A market-driven approach, essentially, that relates Dow's activities directly to current and prospective customer needs as well as industry trends. Along with more attention to market research, industry-oriented organizations within Dow give us the opportunity to analyze trends, forecast needs, more rapidly commercialize new products or technologies or extend an existing line to fill specific market niches."

"Industry orientation characterizes our agricultural chemicals and pharmaceuticals businesses. Our household products business, in part through the recent creation of Dow Consumer Products, Inc., is assuming a similar approach. Each of these businesses is very distinct within Dow and is organized to focus sharply on individual customers and industry segments. We've organized for industry orientation in several other portions of current businesses, too. Electronic materials is one example."

"The electronics industry is the largest in the United States. And, although many Dow products today enjoy wide use in the industry, we have given this market a much higher priority because we can readily build on current product and chemical innovation capabilities and process strengths to deliver the required ultra-high-quality raw materials customers demand. Recently a team of key professionals was assembled to help align our product mix more closely with current and evolving opportunities in electronics . . . to look way beyond individual customers for totally new applications for Dow expertise. In a short period of time, they've brought back some extremely interesting new business possibilities. Everything from a new use for Dow's tried-and-true zippered bag technology to opportunities for handling waste problems."

"This approach represents an evolutionary step for Dow, not wholesale change. From a strategic focus on supplying large volumes of comparatively low-value chemicals, we're steadily shifting toward supplying an increasingly wide range of customers who need lower volumes of high-value products and services."

No company can know the future. But the future can be shaped by foresightful management. The strategies in place for its businesses, people, research and development activities and organization help ensure Dow remains vital to the challenges of the years toward 2000.

Each year is more eventful than the last for a company as dynamic as Dow Chemical, and the past year was no exception. 1985 was a year of:

New Safety Records

1985 was the safest year in Dow's history. There were no fatal injuries during the year, and the Company's frequency rate for lost time injuries per 1,000,000 work hours was 0.11, significantly lower than the best previous performance of 0.17 in 1982, and well below the average for major U.S. chemical companies. The number and dollar value of property damage and business interruption accidents were second lowest, in terms of assets, in Dow history. In 1985, the Company completed two worldwide reviews for possible loss of containment hazards related to chemical production and storage, implementing new programs where required for emergency planning and more rigorous hazard reduction and control.

Cost Reduction

A major cost reduction program comprising asset write-offs and write-downs and personnel reductions resulted in a $592 million pretax charge against 1985 earnings. The program and its impact are addressed in a letter to stockholders from Dow president and chief executive officer, Paul F. Oreffice, beginning page 2 and on pages 14 and 17 in Management's Discussion and Analysis.

Key Acquisitions

Among acquisitions completed in 1985, four in particular were noteworthy:

- the FilmTec Corporation: a Minneapolis, Minnesota-based manufacturer of thin film, spiral wound reverse osmosis membranes used in water purification and other separation applications, FilmTec Corporation represents an excellent complement to Dow's leadership in hollow fiber membrane technology;
- approximately 20 percent of Funai Pharmaceuticals Company of Osaka, Japan: this purchase gives Dow a direct presence in the second largest pharmaceutical market in the world and bolstered the established global position of Merrell Dow Pharmaceuticals Inc.;
- the Texize operations of Morton Thiokol Inc.: completed January 1, this acquisition doubled the size of Dow's consumer products business worldwide and became instrumental in the formation of the subsidiary Dow Consumer Products Inc. in November. Texize brands of cleaning and polishing products include Spray 'n Wash, Glass Plus, Yes, and Fantastik;
- the worldwide polymer chemicals business of The Upjohn Company: representing approximately 22 percent of the world's diphenyl methane diisocyanate (MDI) capacity, Upjohn's polymer chemicals business recorded 1984 sales of $287 million. The addition of MDI capacity complements Dow's current global position in the other two key components of polyurethane foams – toluene diisocyanate (TDI) and polyols – and will enable the company to considerably expand its activity in the urethanes business.

Change on the Board of Directors

Retiring from Dow's board of directors were: J.M. (Levi) Leathers, a Dow vice president; Paul W. McCracken, Edmund Ezra Day Distinguished Professor of Business Administration at the University of Michigan; and G. James Williams, a senior consultant.

Appointed to the board were: Bernard B. Butcher, a vice president of Dow Chemical and director of the corporate product department; Enrique C. Falla, Dow financial vice president; and Harold T. Shapiro, president of the University of Michigan.

New Senior Management Assignments

Andrew J. Butler was named president, Dow Chemical Europe.

Joseph L. Downey was named a vice president of Dow Chemical and president and chief executive officer of Dow Consumer Products Inc., following the creation of that subsidiary.

Wayne M. Hancock was named a vice president of Dow. Hancock serves as general counsel to the Company.

Keith R. McKennon, a group vice president, was named director of research and development. McKennon retained his responsibilities for Dow's legal department and government and public affairs. He was also elected a member of the executive committee of the board of directors.

Frank P. Popoff became an executive vice president and a member of Dow's executive committee. He is responsible for Dow's five geographic areas outside the United States and for employee relations and manufacturing and engineering.

David P. Sheetz was elected a senior vice president and assumed new responsibilities as Dow's first chief scientist.

Enrique J. Sosa was appointed a commercial vice president of Dow U.S.A., responsible for specialty chemicals.

William S. Stavropoulos was named commercial vice president for Dow U.S.A., responsible for basic chemicals.

Yves Bobillier was appointed president of Dow Latin America.

David T. Buzzelli was named president and chief executive officer of Dow Chemical Canada Inc., early in 1986.

Richard J. Fieler was appointed president of Dow Chemical Brazil.

Increased Corporate Contributions

Corporate contributions totaled more than $14 million in 1985, an eight percent increase over the previous year. Approximately one half was devoted to various projects in aid to higher education. Contributions included $1.1 million in support of public education on organ transplants with the American Council on Transplantation.

Enhanced Commitment to Environmental Protection

Capital expenditures associated with environmental control projects increased to $82 million in 1985. The Company's commitment to environmental protection was further strengthened by:

- formation of a global network of environmental quality coordinators to bolster communications and consistency in environmental programs and priorities;
- expanding and bringing together the Company's groundwater technical resources to establish a comprehensive and proactive approach in dealing with existing and potential groundwater problems;
- increasing solid and hazardous waste incineration capacity and efficiency with modern facilities planned and under construction.

Financial Condition and Results of Operations

Effects of Inventory Accounting Change: As a result of high inflation in many foreign countries and the devaluation of many currencies against the U.S. dollar, Dow changed its accounting method for most of its foreign inventories as of January 1, 1985, from the last-in, first-out (LIFO) accounting method. The first-in, first-out (FIFO) or average cost method was adopted for those inventories to provide a better matching of costs and revenue, consistent with conservative accounting practices. Inventories in the United States and Dow's Foreign Sales Corporation, plus foreign hydrocarbon inventories which are largely denominated in U.S. dollars, will remain on LIFO.

The accounting change required the restatement of results for the four prior years. The effect of this was to reduce earnings for 1984 and 1983 by $.13 per share and $.03 per share, respectively, and for 1982 and 1981 by $.41 per share and $.18 per share, respectively.

All references to results for the prior years in the Management's Discussion and Analysis section reflect the impact of the inventory accounting change and restatement.

Results of Operations: 1985 earnings were adversely affected by sluggish demand and intense price competition in many key markets and by the strength of the U.S. dollar overseas. Operating income was $637 million, a decrease of 24% compared to the previous year. Sales rose slightly.

Basic Chemicals: Operating income for Basic Chemicals was $165 million compared to 1984 operating income of $250 million. 1985 sales were $5,237 million, a decrease from the prior year.

Again this year, results in this segment were hampered by excess global capacity and an unfavorable pricing climate exacerbated by the negative impact of imports into the United States. Imports effectively capped prices at unacceptable levels for many products.

Sales and profits for caustic soda were down versus 1984 and were essentially flat for chlorine over the same period. Production cutbacks in ethylene oxide and derivative products and vinyl chloride monomer resulted in lower sales for both products. However, the cutbacks are expected to significantly improve the quality of business for these products beginning in 1986.

Ethyleneamines, chlorinated solvents and magnesium metal products posted strong sales and profit performances. Profits for glycerine reached an all-time high as a result of continued robust demand and positive pricing moves.

A new plant for the production of aspirin was opened in 1985 at Dow's Michigan Division in Midland.

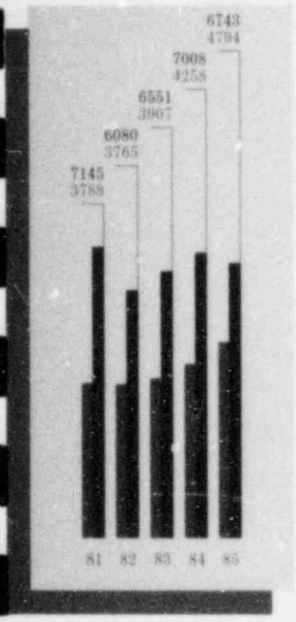
Basic Plastics: Sales for this segment fell 10% against 1984 sales. Operating income decreased to $60 million due primarily to declines in pricing. In anticipation of the start-up of major new capacity in gas-rich countries, prices dropped dramatically late in 1984 but recovered somewhat in the latter half of 1985, as the last of the major plants for polyethylene and styrene monomer in those countries came on-stream.

However, 1985 also saw excellent growth in world markets for polyethylene and Styron polystyrene plastics. Dow's low density polyethylene (LDPE) volume returned to its 1979 peak with Dowlex attaining volume growth of 18%. Additional production capacity for Dowlex was brought on-stream at Fort Saskatchewan, Alberta in the second half of the year and another new plant for Dowlex was authorized for Terneuzen, The Netherlands. Start-up is scheduled for late 1987.

With the demand growth that characterized 1985 and the moderate growth planned for the next few years, global supply-demand patterns are moving into a more favorable balance.

1985 was also marked at Dow by the rationalization of some styrene monomer capacity, the streamlining of polystyrene capacity, the introduction of several new Styron products, and a significant rise in sales of Dowlex products in the Pacific Area as a result of two years of increased resource commitment to this market.

Sales by Product Segment ($ in millions)



- *Basic Chemicals and Plastics*
- *Industrial/Consumer Specialties*

Industrial Specialties: Sales for Industrial Specialties rose 7%. However, operating income declined 41% as a result of decreased earnings in key components of this segment.

Sales and operating income for the epoxy resin and latex product groups fell from the record levels of 1984. The epoxy business was adversely impacted by a worldwide slump in the electronics industry, which characterized much of the year, while softening in coated paper markets and highly aggressive competition in carpet markets significantly constrained performance in the latex group. Dow continues to seek opportunities to broaden the latex product family outside these traditional markets through the development of designed latexes for architectural coatings and adhesives, among other applications.

Performance in urethanes products improved over 1984, despite the impact of costs associated with the acquisition and integration of the polymer chemicals business of The Upjohn Company.

Progress in Dow's expanding engineering thermoplastics business was highlighted by the start-up of the Company's first plant for the production of Calibre polycarbonates and the creation of several important new applications for this product. Costs associated with the start-up constrained 1985 performance for the group but are expected to decline rapidly in 1986. Rovel weatherable polymers saw a significant volume increase while volume for ABS (acrylonitrile-butadiene-styrene) was essentially flat over 1984, reflecting the offset of increased sales to the auto industry by lower demand worldwide for consumer electronic products.

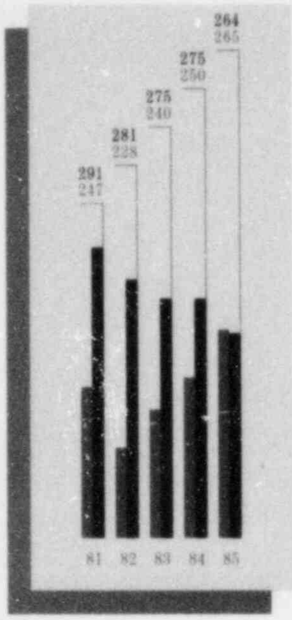
Decreased demand for Saran resins in cellophane coating applications was countered by new growth opportunities in rigid packaging. Dow introduced a pelletized form of Saran in 1985 and a modified product with improved barrier properties.

The fabricated products group of Industrial Specialties recorded a 2% sales gain for 1985. Operating income was off significantly, however, reflecting the impact of costs associated with the start-up of a plant in France for the production of Trycite-oriented polystyrene film and Zetabon plastic clad metal cable wrap operations in Mexico and, in a joint venture plant, Malaysia. This was the first Dow production outside the United States for these products. 1986 is expected to be a turnaround year for fabricated products operating income as these expenses drop sharply.

Lower demand for oil field service products due to reduced activity in that market led to a sales decline of 2% for the functional chemicals group.

Operating income decreased as a result of this volume loss as well as increased costs associated with the development and launch of several new products including a new aqueous fluid absorbent product and Generon air separation systems which provide on-site generation of nitrogen and oxygen using Dow's hollow fiber membrane technology. The acquisition of FilmTec Corporation in 1985 strengthened the Company's global position in membrane technology for reverse osmosis.

Selling Price and Volume/Mix Indexes (1968 = 100)



■ *Selling Price Index*

1985 saw the start-up of newly modernized processes at all three production facilities for Methocel products. These unique processes give Dow an additional 15% of capacity worldwide and an enhanced capability to produce premium grades of Methocel for the food and pharmaceutical industries.

Dow Chemical also increased its worldwide resin capacity with the acquisition of the ion exchange resin business of the Avsind Division of Montedison, S.p.A. The purchase includes Montedison's resin product line and that company's manufacturing plant in Fombio, Italy.

Consumer Specialties: Sales for this segment rose 21% while operating income climbed 74% to $226 million. Profit improvement resulted primarily from the growing contribution of Dow's human health and Dow's household products subsidiaries.

A 7% increase in sales and a dramatic increase in profits helped earn the largest gain of any business category for the Company's global human health subsidiary.

Major elements of this achievement included the rapid growth of probucol following its launch in Japan and continued growth of terfenadine abroad and rapid market penetration following its U.S. introduction. Terfenadine, a non-sedating antihistamine sold under the trademarks Seldane, Teldane and Triludan, became the largest selling branded antihistamine in the world. Nicorette smoking cessation gum also continued to show strength in the U.S. and Canada. Merrell Dow earnings were significantly aided by earlier cost reduction, integration and consolidation activities. The best gains were posted by the United States, Japan and Canada.

Significant progress was made in the development of new prescription and over-the-counter products. The spring of 1986 will see the U.S. launch of Citrucel, methyl cellulose-based bulk laxative. There are also plans to file at least one new drug application for a major product in Europe as well as applications in many other areas of the world for the first major line extension of terfenadine.

The household products group recorded a 13% sales gain during 1985, excluding Texize and discontinued products. Operating income rose significantly as a result of strong performances by Ziploc, Saran Wrap and Handi-Wrap products and DOW Bathroom Cleaner.

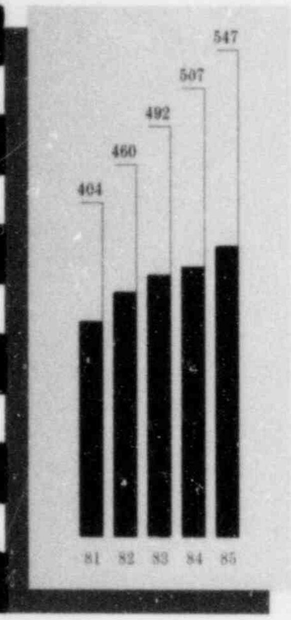
Results for the Texize product group, which was acquired from Morton Thiokol Inc., were punctuated by a 7% sales increase and a highly successful promotion entitled "Operation Kidsafe." The promotion involved most Texize brands and helped raise more than $700,000 for the (U.S.) National Center For Missing and Exploited Children and the National Crime Prevention Council.

To foster better coordination of global product strategies for this group, the Company consolidated the operations of Texize and Dow's existing household products business into a separate subsidiary, Dow Consumer Products Inc.

Agricultural chemical sales rose 5% but operating income fell due to depressed conditions in U.S. farm markets with preseason orders moving into 1986. Start-up of several major facilities and a significant resource infusion also impacted 1985 profits. The group is expected to return to previous return-on-sales levels in 1986.

Early in 1986, the United States Environmental Protection Agency granted the registration of Tandem herbicide for the post-emergent control of weeds in corn. The product will be introduced in the U.S. during the 1986 growing season. Starane herbicide for small grains was successfully launched in the United Kingdom and France adding another new compound to Dow's extensive herbicide and insecticide line.

Research and Development ($ in millions)



Sales: Net sales increased 1% to $11.5 billion in 1985, after rising by 4% in 1984. Physical volume was up 6% in 1985, following a 4% volume increase in 1984. Physical volume in the U.S. rose 2% in 1985, while the collective increase in Europe and the rest of world was 9%.

Selling prices fell 4% in 1985. Prices were flat in 1984 after a price erosion of 2% in 1983. Prices decreased in the U.S. and Europe by 4% while the rest of the Company experienced price erosion of 7% for the year. However, there was some price restoration in the last three quarters of the year after sharp declines in the fourth quarter of 1984 and the first quarter of 1985. This together with the weakening of the dollar, especially in Europe in the second half of 1985, indicate an improved pricing climate for the Company in 1986.

Sales by segment are presented in greater detail in Notes to Financial Statements and in the Product Segment Sales Analysis on page 37.

Percent changes in sales by geographic and industry segments were:

(Percent change from prior year)	1985	1984
Geographic areas:		
United States	(2)	1
Europe	7	8
Rest of world	(2)	6
Industry segments (excluding Dowell):		
Basic Chemicals	(2)	8
Basic Plastics	(10)	4
Industrial Specialties	7	7
Consumer Specialties	21	12

Operating Income: Operating income for 1985 was $637 million compared to $836 million in 1984, reflecting the impact of lower sales prices in 1985. This was partially offset by continued cost containment and lower hydrocarbons and energy prices. Operating income in 1983 was $501 million. The ratio of operating income to sales was 6% in 1985, 7% in 1984, and 5% in 1983.

Dow Chemical Europe realized another excellent year with an operating income of $286 million in 1985 or 45% of the Company's total; in contrast, the U.S. business was experiencing soft prices and sluggish demand, generating operating income of $255 million or 40% of the Company's total.

Operating income by geographic and industry segment can be found in greater detail in the Notes to Financial Statements.

Manufacturing plants operating rate remained unchanged at 81% of capacity in 1985 and 1984 versus 76% in 1983. A reduction of certain inventories in 1985 and 1984 resulted in liquidation of some quantities of LIFO inventory. The effect of these liquidations was to decrease pretax income $14 million in 1985 and to increase pretax income $7 million and $95 million for 1984 and 1983, respectively.

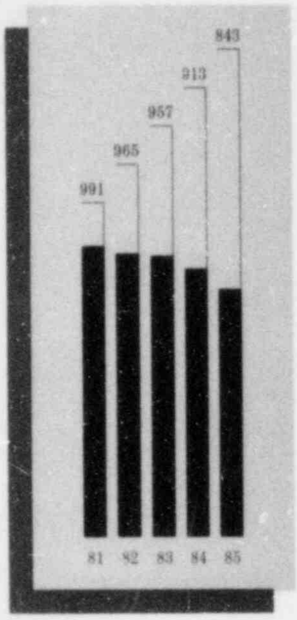
Major components of operating costs and expense were:

(Percent of total)	1985	1984	1983
Hydrocarbons and energy	29	35	37
Supplies, services and other raw materials	38	32	30
Maintenance	6	7	6
Depreciation	9	8	8
Salaries, wages and benefits	18	18	19
	100	100	100

Manufacturing costs were 6% lower in 1985 adjusted for volume. The most significant decrease was in hydrocarbon and energy prices, which declined by 8% in 1985, following a 5% decline in 1984 and a 1% decline in 1983. Research and development costs increased by 8% and 3% in 1985 and 1984, respectively.

Salaries, wages and benefits increased by 6% in 1985, as personnel count increased by more than 3,400 people, following a decline of more than 4,700 in 1984. Of the personnel increase in 1985, some 3,000 came by way of acquisitions and the inclusion of all the Dow Financial Service Corporation personnel. The primary reason for the decline during 1984 was the sale of 50% of Dowell to Schlumberger Limited.

Energy and Hydrocarbon Purchase Price Index (1968 = 100)



Net Income: Equity in earnings of 20%-50% owned companies increased $101 million in 1985 following a decrease of $34 million in 1984. Dow's share of earnings in Dow Corning and MT Partnership increased by more than $18 million, and the Dowell Schlumberger companies by $64 million in 1985. Equity in earnings were reduced by $50 million in 1984 due to write-offs and consolidation expenses taken by the Dowell Schlumberger companies.

Interest expense was down by $47 million in 1985, despite a debt increase related to acquisitions completed during the year. Interest expense is expected to remain at this level in 1986, reflecting lower U.S. interest rates. Total debt increased by $507 million in 1985, following a decline of $344 million in 1984, and $187 million in 1983.

Foreign currency transaction gains of consolidated subsidiaries were $52 million in 1985, an increase of $38 million from 1984. Cumulative translation adjustments resulted in a $20 million increase to stockholders' equity at year-end 1985 as compared to a $37 million decrease at year-end 1984. Translation adjustments of $135 million in 1985 were partially offset by $78 million of losses from hedges, net of related income taxes.

Results for 1985 included a special pretax charge of $592 million for a program of personnel reductions and asset-related write-offs and write-downs. Reductions of more than 2,700 employees worldwide will result from the shutdown of some operations and through various transition programs. The provision for costs associated with this element of the program was $121 million. The asset-related element of the program was concentrated in Dow's basic chemicals and plastics businesses, primarily in the U.S.

Analysis of special charge (millions of dollars)		
Personnel-related costs:		$121
Asset-related costs:		
Basic Chemicals/Plastics	$410	
Industrial Specialties	27	
Consumer Specialties	17	
Other	17	471
Total special charge		$592

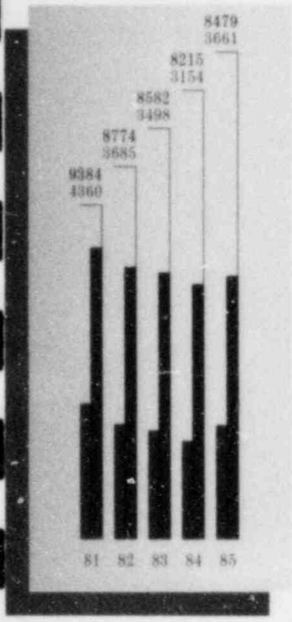
In 1984, Dow's mothballed crude oil processing plant (COPP) was written down, resulting in a pretax charge of $157 million. In 1983, pretax charges for plant closings and cancelled projects amounted to $58 million.

Gains from the sale of 50% of Dowell to Schlumberger Limited in the second and third quarters of 1984 generated pretax income of $183 million. This compares to a pretax gain in 1983 of $101 million from asset sales. These included selected oil and gas properties sold by Maligne Resources, a Canadian subsidiary, to Dome Petroleum Ltd., and depositary units of Apache Petroleum Company.

Taxes other than income for Dow including payroll, property, franchise, Superfund and other taxes amounted to $298 million, $293 million, and $286 million in 1985, 1984 and 1983, respectively. The provision for taxes on income was a credit of $28 million in 1985, primarily due to future tax effects related to the 1985 special charge program. This compares to a tax provision, excluding taxes related to extraordinary items, of $139 million and $144 million in 1984 and 1983, respectively. The factors that influenced the Company's overall effective tax rate for the past three years are described in the Notes to Financial Statements.

Net income in 1984 included an extraordinary gain of $36 million from the realization of foreign tax loss carryforwards, whereas net income in 1983 included extraordinary gains of $41 million from the redemption of long-term debt.

Total Capitalization vs. Total Debt ($ in millions)



▪ *Total Capitalization*
▪ *Total Debt*

Dividends: The Company paid dividends of $1.80 per share in 1985, the same amount paid since 1981. The Company has paid consecutive quarterly dividends for 73 years.

Capital Expenditures: Additions to plant properties for the year were $806 million compared to $781 million in 1984 and $630 million in 1983. Capital spending in support of the Company's specialty businesses continued to grow as a percentage of total capital expenditures. Industrial and Consumer Specialties consumed 47% of capital spending versus 38% and 31% in 1984 and 1983, respectively. Operating leases with an asset value of $85 million were contracted in 1985, compared to $188 million in 1984 and $325 million in 1983.

Liquidity and Capital Resources: Funds provided from operations decreased $587 million after increasing $231 million in the previous year. The sale of 50% of Dowell generated $440 million of cash before tax in 1984, while asset sales contributed more than $200 million in 1983.

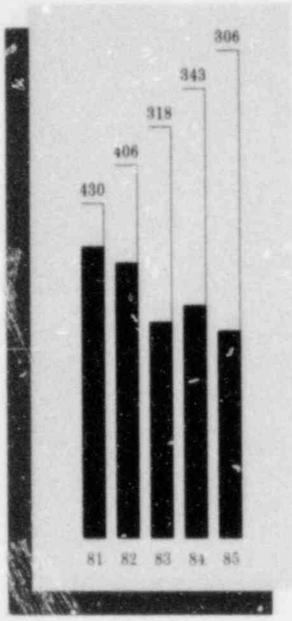
The ratio of debt to debt-plus-equity at year-end 1985 was 43%, up from 38% in 1984 and 41% in 1983. Total debt was $3.7 billion at December 31, 1985, an increase of $507 million over 1984 and $163 million higher than the 1983 level. In 1983, the Company issued 1.2 million common shares plus cash in a tax-free exchange for long-term debt having a face value of $100 million.

Working capital remained at $1.3 billion at year-end 1985, the same as 1984 and 1983. The ratio of current assets over current liabilities was 1.5:1 in 1985, compared to 1.5:1 and 1.4:1 in 1984 and 1983, respectively. Inventories and trade receivables increased $277 million at year-end 1985 after a decrease of $330 million in 1984. Inventories were 4% higher, while days-sales-in-inventory was 91 days at December 31, 1985, compared to 96 days in 1984 and 90 days in 1983. Days-sales-outstanding in accounts receivable were 52 days at year-end, 51 days in 1984 and 53 days in 1983.

Short-term borrowings at December 31, 1985 and 1984 were $289 million and $250 million, respectively, substantially lower than the $694 million outstanding in 1983. In 1985, new long-term debt increased $639 million. In May, the Company issued zero coupon Eurosterling bonds with a maturity amount of 300 million pounds sterling due in 12 years that netted $105 million. In August, the Company issued $200 million of extendible promissory notes, which were issued under the shelf registration filed by Dow in August of 1983 with the United States Securities and Exchange Commission. In addition, in October, Dow issued 300 million Deutsche mark bonds yielding $111 million, Eurodollar promissory notes of $100 million and $86 million in pollution control bonds used to finance qualified projects. The Company expects to continue to utilize the latter form of financing when available.

The Company has unused and available credit facilities with various United States and foreign banks totaling $1.4 billion in support of commercial paper borrowings and working capital requirements. These arrangements are supplemented by a variety of other credit facilities available for use by foreign subsidiaries. In addition, the Company filed a shelf registration in August 1983 with the United States Securities and Exchange Commission covering $500 million of debt securities, of which $200 million has been issued to date. Present committed lines of credit are considered to be in excess of estimated needs and will be reduced in 1986. Based on projected internal cash generation, current levels of liquid assets and the projected credit capacity in support of additional financing, the Company expects to continue to finance competitively operating cash requirements, planned capital expansion and dividend requirements.

Net Interest
($ in millions)



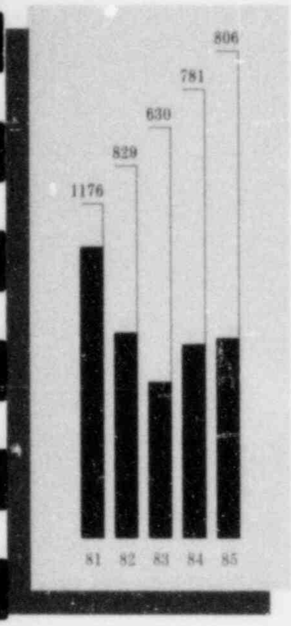
Quarterly Statistics (unaudited):

(in millions, except per share amounts)

1985	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
Net sales	$2,753	$3,002	$2,873	$2,909	$11,537
Operating income	171	227	128	111	637
Net income	110	155	107	(314)	58
Earnings per common share	.58	.81	.56	(1.64)	.31
Cash dividends paid					
per common share	.45	.45	.45	.45	1.80
Market price range of common stock:					
High	30.88	36.13	37.13	41.88	41.88
Low	27.00	28.00	33.63	33.50	27.00

1984					
Net sales	$2,916	$2,986	$2,829	$2,687	$11,418
Operating income	241	291	205	99	836
Income before extraordinary items	132	172	150	70	524
Net income	132	186	157	85	560
Earnings per common share:					
Income before extraordinary items	.67	.89	.77	.37	2.70
Net income	.67	.96	.81	.45	2.89
Cash dividends paid					
per common share	.45	.45	.45	.45	1.80
Market price range of common stock:					
High	34.50	33.13	32.00	30.38	34.50
Low	27.13	26.88	25.75	26.88	25.75

Capital Expenditures
($ in millions)



The fourth quarter of 1985 included a special pretax charge of $592 million for a program of personnel reductions and asset-related write-offs and write-downs.

Personnel-related costs represented $121 million of the program. The remainder, $471 million, was composed of asset-related write-offs and write-downs. The bulk of these were concentrated in Dow's basic chemicals and plastics businesses and had the effect of significantly reducing excess capacity in those businesses.

The program included 23 idled facilities or plants with scheduled shutdowns and 11 cancelled projects were written off. Write-downs were taken for 16 operating plants. The most noteworthy capacity changes included a permanent reduction of:

- approximately 20% of Dow's vinyl chloride capacity;
- almost 15% of Dow's chlorine capacity which represents a reduction of nearly 3% (or two years' growth) in global industry capacity.

Benefits of this program will begin in the first quarter of 1986 and are expected to result in a nearly equal division of personnel-related savings and asset-related cost reductions.

The second and third quarters of 1984 included pretax gains of $163 million and $20 million, respectively, from the sale of 50% of Dowell. The after-tax effect was $.55 per share in the second quarter and $.10 per share in the third quarter. The second quarter also included a pretax charge of $157 million from the write-down of COPP, which reduced net earnings by $.43 per share.

Earnings benefited from changes in federal tax law that cancelled deferred taxes on Domestic International Sales Corporations (DISC). The effect on the changes was $32 million ($.17 per share) in the second quarter and $39 million ($.20 per share) in the third quarter of 1984.

Earnings for the last three quarters of 1984 included extraordinary income from the realization of foreign tax loss carryforwards of $14 million, $7 million and $15 million, respectively, a total of $.19 per share for the year.

Supplementary Information on Effects of Changing Prices: Refer to page 36 for the disclosure of supplementary financial information on effects of changing prices.

CONSOLIDATED STATEMENT OF INCOME

December 31 (in millions, except per share amounts)	1985	1984 Restated	1983 Restated
Net sales	$11,537	$11,418	$10,951
Operating costs and expenses			
Cost of sales	9,615	9,528	9,461
Selling and administrative	1,285	1,054	989
Total operating costs and expenses	10,900	10,582	10,450
Operating income	637	836	501
Other income (expense)			
Equity in earnings:			
Nonconsolidated subsidiaries	48	23	12
20%-50% owned companies	151	50	84
Interest income	79	89	106
Interest and amortization of debt discount and expense	(385)	(432)	(424)
Gains on foreign currency transactions	52	14	66
Gains on sale of investments		183	101
Special charges	(592)	(157)	(58)
Sundry income – net	40	57	43
Income before provision for taxes on income	30	663	431
Provision for taxes on income	(28)	139	144
Income before extraordinary items	58	524	287
Extraordinary items			
Tax benefit from realization of foreign tax loss carryforwards		36	
Gain on redemption of long-term debt			41
Net income	$ 58	$ 560	$ 328
Earnings per common share			
Income before extraordinary items	$ .31	$ 2.70	$ 1.47
Extraordinary items:			
Tax benefit from realization of foreign tax loss carryforwards		.19	
Gain on redemption of long-term debt			.21
Net income	$ .31	$ 2.89	$ 1.68

See Accounting Policies and Notes to Financial Statements.

CONSOLIDATED BALANCE SHEET

December 31 (in millions)	1985	1984 Restated
Assets		
Current Assets		
Cash	$ 11	$ 19
Marketable securities and interest-bearing deposits (at cost, approximately market)	103	102
Accounts and notes receivable:		
Trade (less allowance for doubtful receivables – 1985, $41; 1984, $37)	1,580	1,380
Other	607	503
Inventories:		
Finished and work in process	1,554	1,442
Materials and supplies	469	504
Total current assets	4,324	3,950
Investments		
Capital stock of related companies – at cost plus equity in accumulated earnings:		
Banking and insurance subsidiaries	257	214
20%-50% owned companies	993	938
Other investments (at cost)	196	338
Noncurrent receivables	274	384
Total investments	1,720	1,874
Plant properties	11,875	11,256
Less – accumulated depreciation	6,748	6,083
Net plant properties	5,127	5,173
Goodwill	265	202
Deferred charges and other assets	394	164
Total	$11,830	$11,363
Liabilities		
Current liabilities		
Notes payable	$ 289	$ 250
Long-term debt due within one year	174	234
Accounts payable:		
Trade	1,028	947
Other	255	203
United States and foreign taxes on income	295	305
Accrued and other current liabilities	934	737
Total current liabilities	2,975	2,676
Long-term debt	3,198	2,670
Deferred taxes and other liabilities		
Deferred income taxes	331	617
Other noncurrent obligations	508	339
Total deferred taxes and other liabilities	839	956
Minority interests in subsidiary companies	26	21
Stockholders' equity		
Common stock (authorized 500,000,000 shares of $2.50 par value each; issued – 1985, 211,158,318; 1984, 208,613,652)	528	522
Additional paid-in capital	652	597
Retained earnings	4,058	4,341
Cumulative translation adjustments	20	(37)
Treasury stock, at cost (1985, 20,998,026; 1984, 18,521,367 shares)	(466)	(383)
Net stockholders' equity	4,792	5,040
Total	$11,830	$11,363

See Accounting Policies and Notes to Financial Statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

December 31 (in millions)	1985	1984 Restated	1983 Restated
Common stock			
Balance at beginning of year	$ 522	$ 516	$ 510
Sold to employees	6	6	6
Balance at end of year	$ 528	$ 522	$ 516
Additional paid-in capital			
Balance at beginning of year	$ 597	$ 552	$ 516
Sale of common stock to employees in excess of par	55	45	44
Excess of cost over market value of treasury shares issued in exchange for long-term debt			(8)
Balance at end of year	$ 652	$ 597	$ 552
Retained earnings			
Balance at beginning of year (as previously reported)	$4,361	$4,123	$4,141
Retroactive inventory accounting change (Note A)	(20)	5	11
Balance at beginning of year (as adjusted)	4,341	4,128	4,152
Net income	58	560	328
Cash dividends declared ($1.80 per share)	(341)	(347)	(352)
Balance at end of year	$4,058	$4,341	$4,128
Cumulative translation adjustments			
Balance at beginning of year	$ (37)	$ 8	$ 18
Current year translation adjustment	57	(45)	(10)
Balance at end of year	$ 20	$ (37)	$ 8
Treasury stock			
Balance at beginning of year	$ 383	$ 153	$ 127
Purchase of stock	83	230	73
Exchanged for long-term debt			(47)
Balance at end of year	$ 466	$ 383	$ 153

See Accounting Policies and Notes to Financial Statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

December 31 (in millions)	1985	1984 Restated	1983 Restated
Operations			
Income before extraordinary items	$ 58	$ 524	$ 287
Charges (credits) to income not requiring (providing) funds:			
Depreciation	977	908	841
Equity in net income of nonconsolidated companies, less dividends received	(58)	49	1
Deferred income taxes	(183)	(100)	21
Funds provided from operations	794	1,381	1,150
Working capital			
Current accounts and notes receivable	(235)	269	(232)
Inventories	(9)	(71)	(195)
Accounts payable and accrued liabilities	275	(156)	409
Notes payable and long-term debt due within one year	(21)	(279)	488
Funds provided (used) for working capital	10	(237)	470
Investment activities and other			
New plant properties	(806)	(781)	(630)
Acquisition of businesses:			
Plant properties and intangibles	(377)		
Working capital	(92)		
Goodwill	(69)		
Investment in related companies	(39)	22	(14)
Book value of asset disposals		303	181
Noncurrent receivables and sundry assets	210	(329)	(126)
Noncurrent liabilities	170	75	23
Extraordinary items		36	41
Other	27	60	(50)
Funds used for investment activities and other	(976)	(614)	(575)
Financing activities			
Long-term debt	639	303	158
Long-term debt reduction	(111)	(364)	(833)
Treasury stock purchases	(83)	(230)	(73)
Dividends declared	(341)	(347)	(352)
Sale of common stock to employees	61	51	50
Funds provided (used) from financing activities	165	(587)	(1,050)
Net funds used	(7)	(57)	(5)
Cash and marketable securities, beginning of year	121	178	183
Cash and marketable securities, end of year	$ 114	$ 121	$ 178

See Accounting Policies and Notes to Financial Statements.

Responsibility for Financial Statements

The consolidated financial statements and related notes of The Dow Chemical Company and its subsidiaries were prepared by management in accordance with generally accepted accounting principles. The board of directors, through its audit committee, assumes an oversight role with respect to the preparation of the financial statements.

The Company is responsible for the integrity and objectivity of the consolidated financial statements, which are presented in a consistent manner on the accrual basis of accounting. Established accounting procedures are designed to provide accurate books, records and accounts, which fairly reflect the transactions of the Company.

The training of qualified personnel and the assignment of duties are intended to provide internal controls at a cost appropriate to management's evaluation of the risks involved. Such controls are monitored by an internal audit staff, providing reasonable assurances that transactions are executed in accordance with management's authorization and that adequate accountability for the Company's assets is maintained.

Deloitte Haskins & Sells, independent public accountants, with direct access to the board of directors through its audit committee, have examined the consolidated financial statements prepared by the Company, and their report follows.

Opinion of Independent Public Accountants

To the Stockholders and Board of Directors
of The Dow Chemical Company

We have examined the consolidated balance sheets of The Dow Chemical Company and its consolidated subsidiaries as of December 31, 1985 and 1984 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of The Dow Chemical Company and its consolidated subsidiaries at December 31, 1985 and 1984 and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis, after restatement for the change, with which we concur, in the method of accounting for foreign inventories as described in Note A to the consolidated financial statements.

Deloitte Haskins & Sells

Midland, Michigan
February 12, 1986

Summary of Significant Accounting Policies

Consolidation. The accompanying consolidated financial statements include the assets, liabilities, revenues and expenses of all significant majority-owned subsidiaries except for banking and insurance companies. Because of the nature of their operations, the accounts of these companies are not consolidated. However, their earnings are included in consolidated net income under the equity method of accounting.

Nonconsolidated Investments. Investments in companies 20%-50% owned are carried on the equity basis. Marketable securities are carried at the lower of cost or market. Other investments are carried at cost less reserves.

Foreign Currency Translation. Effective January 1, 1983, foreign currency transactions and financial statements are translated in accordance with Statement of Financial Accounting Standards No. 52 (SFAS No. 52). The United States dollar is used as the functional currency throughout the world except for operations in Germany, Japan and Dow Financial Services

Corporation, for which local currencies are used. Where the United States dollar is used as the functional currency, foreign currency gains and losses are reflected in income currently. Translation gains and losses of those operations that use local currencies as the functional currency, the effects of exchange rate changes on transactions designated as hedges of net foreign investments, and foreign currency intercompany transactions are included as a separate component of stockholders' equity.

Inventories. Inventories are stated at cost, which is less than market value. The cost of substantially all domestic, foreign hydrocarbon and Foreign Sales Corporation inventories were determined by the last-in, first-out method for raw material and product inventories. The cost of the Company's operating supplies and non-hydrocarbon foreign raw material and product inventories were determined by the first-in, first-out or average cost method.

Plant Properties and Depreciation. Land, buildings and equipment, including property under capital lease agreements, are carried at cost less accumulated depreciation. Depreciation is based on the estimated service lives of depreciable assets and is generally provided using the declining balance method.

Fully depreciated assets are retained in the property and depreciation accounts until they are removed from service. In the case of disposals, the assets and related depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to income.

Goodwill. The excess of the cost of investments in subsidiaries over the carrying value of assets acquired is shown as goodwill. Goodwill arising since October 1970 is amortized over 40 years. In the opinion of management, goodwill prior to that date requires no amortization.

Retirement Plans. The Company and certain subsidiaries have plans which provide retirement benefits for eligible employees. The major plan covers substantially all full-time United States employees. The policy is to accrue and fund pension cost as computed by an actuary.

Taxes on Income and Investment Credits. The Company and its subsidiaries compute and record income taxes currently payable based upon their determination of taxable income which may be different from pretax accounting income. These differences may arise from recording in pretax accounting income transactions which enter into the determination of taxable income in another period. The tax effect of these timing differences is recognized by an adjustment to the provision for taxes.

Provision is made for taxes on that income of subsidiaries taxable in the United States as earned, and on unremitted earnings of subsidiary and related companies to the extent that such earnings are not deemed to be permanently invested.

Laws governing the determination of United States and certain foreign income taxes provide for investment credits for acquisition of qualified facilities. Such credits are reflected as a reduction of income tax expense on the flow-through basis in the year in which they are earned.

In addition to tax credits, certain foreign countries provide incentives which are granted to encourage new investment. Generally, such grants are credited to income as earned.

Earnings per Common Share. The calculation of earnings per share is based on the weighted average number of common shares outstanding during the applicable period.

Reclassification. The Company has reclassified the presentation of certain prior year information to conform with the current presentation format.

NOTES TO FINANCIAL STATEMENTS (dollars in millions, except per share)

A Accounting Change

As a result of continued high inflation rates in many foreign countries and the devaluation of their currencies against the U.S. dollar, Dow's worldwide use of the last-in, first-out (LIFO) inventory accounting method no longer yields the best matching of costs and revenue. Effective January 1, 1985, management has decided to change its method of accounting for most of the foreign inventories from LIFO and adopt the first-in, first-out (FIFO) or average cost methods to provide a better matching of costs and revenue, consistent with conservative accounting practices.

Inventories in the United States and Dow's Foreign Sales Corporation, plus foreign hydrocarbon inventories, remained on LIFO.

On a restated basis, net income was reduced $25 or $.13 per share and $6 or $.03 per share in 1984 and 1983, respectively, and $78 or $.41 per share and $34 or $.18 per share in 1982 and 1981, respectively.

All reference to results for these years in the Notes to Financial Statements reflect the impact of the accounting change and restatement.

B Interest Cost

Interest and Amortization of Debt Discount and Expense

	1985	1984	1983
Interest incurred on debt	$413	$460	$471
Less – interest capitalized	28	28	47
Net	$385	$432	$424

C Supplementary Information

Accrued and Other Current Liabilities

	1985	1984
Accrued vacations	$133	$121
Employees' retirement plan	135	110
Interest payable	127	110
Sundry	539	396
Total	$934	$737

Sundry Income – Net

	1985	1984	1983
Royalty income	$ 15	$ 16	$ 22
Profit on securities	10	11	6
Dividend income	8	10	
Other – net	7	20	15
Total	$ 40	$ 57	$ 43

Supplementary Income Statement Information

	1985	1984	1983
Maintenance and repairs	$711	$704	$614
Depreciation and depletion	977	908	841
Research and development	547	507	492
Taxes other than income:			
Property and other taxes	156	143	136
Payroll taxes	142	150	150
Provision for doubtful receivables	6	6	21
Advertising	193	127	112

D Acquisitions and Divestitures

On January 1, 1985, the Company acquired the Texize Division of Morton Thiokol Inc., a manufacturer and marketer of household cleaning and other related products, for $123 in cash and approximately 4.2 million shares of Morton Thiokol common stock owned by Dow. The acquisition was accounted for as a purchase, and the excess cost over the fair value of the net assets acquired of $52 is being amortized on a straight-line basis over 40 years.

Effective August 1, 1985, the worldwide polymer chemicals business of The Upjohn Company was acquired for cash. The acquisition was accounted for as a purchase and consideration of $232 approximated the fair value of the net assets acquired. In addition, Dow acquired for cash on August 7, 1985, all of the capital stock of FilmTec Corporation, a manufacturer of reverse osmosis membranes used in water purification and other separation applications. The total purchase cost of $75 exceeded the fair value of net assets acquired by $17 which is being amortized over 40 years.

The operating results of 1985 acquisitions are included in the consolidated financial statements from the dates acquired. There would have been no material impact on revenue, income before extraordinary items, net income and corresponding per share amounts had those acquisitions been effected January 1, 1983.

During 1984, the Company completed the sale of 50% of its Dowell oil field service business and assets in the United States and Canada to Schlumberger Limited for approximately $440 in cash. A pretax gain of $183, or $.65 per share after tax, was recognized. The Company also acquired several small specialty businesses in 1984, each of which was accounted for as a purchase.

The Company acquired the remaining 50% interest in Cordis Dow Corp. and four other small subsidiaries in 1983. Also during 1983, Maligne Resources Limited, a Canadian subsidiary, sold selected oil and gas properties to Dome Petroleum Ltd. for approximately $88. Pretax income realized was $51 and Dome's obligation to purchase additional oil and gas properties from Maligne was cancelled.

E Special Charges

The fourth quarter of 1985 included a special pretax charge of $471 for asset-related write-offs and write-downs and $121 for personnel-related costs. These asset-related elements were concentrated in Dow's basic chemicals and plastic businesses, primarily in the United States, with the effect of reducing excess capacity.

In 1984, the Company reduced the carrying value of its mothballed crude oil processing plant in Texas based on an independent appraisal. The adjustment reduced pretax profits by $157.

Earnings for the fourth quarter of 1983 included a pretax charge of $58, reflecting the decision to close permanently idle plants and cancel some expansion projects. These write-offs included plants for chlorine/caustic soda, ethylene oxide/ethylene glycol and ethylene.

F Taxes on Income

The tax provision was reduced by general business and other tax credits of $59 in 1985, $35 in 1984 and $67 in 1983. The Company had available at December 31, 1985, general business credit carryforwards totaling $128 for tax purposes, which expire beginning in 1998. In addition, certain subsidiaries had net operating loss carryforwards totaling approximately $133 (at December 31, 1985, exchange rates) which expire in 1986 through 1999.

Current deferred taxes payable included in the Consolidated Balance Sheet caption "United States and foreign taxes on income" were $88 and $70 at December 31, 1985 and 1984, respectively.

Taxes on Income (continued)

Unremitted earnings of subsidiary and related companies accounted for by the equity method, which are deemed to be permanently invested, amounted to $1,644 and $1,553 at December 31, 1985 and 1984, respectively.

Domestic and Foreign Components of Pretax Income (Loss)[1]

	1985	1984	1983
Domestic	$(197)	$198	$ 98
Foreign	227	465	333
Income before tax	$ 30	$663	$431

Provision for Taxes on Income

	1985			1984			1983[2]		
	Current	Deferred	Total	Current	Deferred	Total	Current	Deferred	Total
Federal	$(25)	$(171)	$(196)	$ 43	$(120)	$(77)	$(16)	$(18)	$(34)
State and local	5		5	2		2			
Foreign	175	(12)	163	158	20	178	139	39	178
Tax benefit of loss carryforwards				36		36			
Total	$155	$(183)	$ (28)	$239	$(100)	$139	$123	$ 21	$144

Deferred Tax Provisions	1985	1984	1983
Tax benefits of tax credit and loss carryforwards	$ 13	$ 26	$(161)
Tax effects of foreign exchange transactions	21	11	(9)
Difference in depreciation, depletion, and provisions claimed for tax purposes and book amounts	(130)	(55)	125
Undistributed earnings of foreign subsidiaries deemed not to be permanently invested	(1)		12
Tax effects of deferred compensation plans	(35)	(12)	9
Income of export and shipping companies operating outside the United States	(2)	(15)	(8)
Tax effects of installment sales	(21)	10	
DISC deferred tax reversal		(71)	
Difference between LIFO method claimed for tax purposes and book amounts	(16)	(4)	45
Other – net	(12)	10	8
Total	$(183)	$(100)	$ 21

Major Differences in Taxes on Income	1985	1984	1983
Taxes at U.S. statutory rate	$ 14	$ 305	$ 198
U.S. investment and other domestic tax credits	(42)	(26)	(58)
Taxes on foreign operations at rates different from U.S. statutory rate (including DISC/FSC)	42	(56)	12
DISC deferred tax reversal		(71)	
Untaxed equity in income of companies whose accounts are not consolidated	(25)	21	(4)
Capital gains	(8)	(48)	
Other	(9)	14	(4)
Total tax provision	$ (28)	$ 139	$ 144

[1] *Before extraordinary items, classified primarily by the domicile of each company.*

[2] *1983 data excludes $14 tax related to the extraordinary item.*

G Extraordinary Items

Earnings for 1984 included an extraordinary gain of $36, or $.19 per share, resulting from realization of foreign tax loss carryforwards.

Net income for 1983 included $15, or $.08 per share, of extraordinary gain, net of related income taxes of $14, from the cash redemption of Dow bonds having an aggregate face value of $107.

In 1983, the Company also issued 1.2 million shares of its common stock plus cash in a tax-free exchange for Dow bonds having a face value of $100. This exchange of long-term debt for equity resulted in an extraordinary gain of $26, or $.13 per share.

H Inventories

A reduction of certain inventories in each of the three years in the period ended December 31, 1985, resulted in the liquidation of some quantities of LIFO inventory. The effects of these liquidations were to decrease pretax income $14, and to increase pretax income $7 and $95 for the years ended December 31, 1985, 1984 and 1983, respectively.

The amount of reserve required to reduce inventories from the first-in, first-out basis to the last-in, first-out basis at December 31, 1985 and 1984, was $155 and $168, respectively.

At December 31, 1985, 54% of the total inventories were valued on a LIFO basis.

I Related Company Transactions

The Company's investments in nonconsolidated subsidiaries and companies 20%-50% owned at December 31, 1985 and 1984, were $1,250 and $1,152, respectively. These amounts approximate the Company's equity in the net assets of those investments. Dividends received from related companies were $141 in 1985, $122 in 1984 and $97 in 1983.

Noncurrent receivables at December 31, 1985 and 1984, included $98 and $141, respectively, from related companies. Interest income from related companies was $6 in 1985, $11 in 1984 and $18 in 1983.

All other transactions with related companies, and balances due to or from related companies, were not material in amount.

J Plant Properties

Plant Properties	1985	
Land	$ 221	[illegible]
Land and waterway improvements	362	332
Buildings	1,060	955
Machinery and equipment	8,987	8,448
Wells and brine systems	270	256
Office furniture and equipment	225	193
Oil and gas land and leaseholds	15	13
Other	182	224
Construction in progress	553	636
Total	$11,875	$11,256

K Leased Properties

Minimum operating lease commitments have not been reduced by minimum sublease rentals of $6 due in the future under noncancellable subleases.

Minimum Lease Commitments

	Operating Leases	Capital Leases
1986	$ 168	$ 12
1987	151	11
1988	139	10
1989	122	9
1990	112	8
1991 and thereafter	1,068	45
Total minimum lease payments	$1,760	95
Less – estimated to represent interest		33
Present value of minimum lease obligations		62
Less – current accounts payable		7
Long-term capital lease obligations		$ 55

Capital Leases[1]	1985	1984
Buildings	$ 1	$ 1
Machinery and equipment	115	120
Subtotal	116	121
Less – accumulated depreciation	88	89
Net	$ 28	$ 32

Rental Expenses Under Operating Leases	1985	1984	1983
Minimum rentals	$222	$232	$206
Contingent rentals	4	3	3
Less – Sublease rentals	(12)	(19)	(2)
Net	$214	$216	$207

L Notes Payable

Notes payable at December 31, 1985 and 1984 consisted of obligations due banks with a variety of interest rates and maturities. Notes payable at December 31, 1985, also included commercial paper in the amount of $3.

M Long-term Debt and Available Credit Facilities

Long-term debt is stated net of debentures purchased to satisfy future sinking fund requirements.

The average interest rate on long-term debt was 8.8% in 1985 compared to 9.5% in 1984.

Annual installments on long-term debt and capital lease obligations for the next five years are as follows: 1986, $174; 1987, $51; 1988, $63; 1989, $85; 1990, $131.

[1] *Included with owned property on balance sheet.*

Unused and available credit facilities from various United States banks totaling $80 at December 31, 1985, required the retention of average cash balances aggregating approximately $4. These requirements were generally satisfied by balances maintained for normal business operations. Additional unused and available credit facilities with various United States and foreign banks totaling $1,335 at December 31, 1985, required the payment of commitment fees.

Both of these groups of facilities, totaling $1,415, are available in support of commercial paper borrowings and working capital requirements.

Additional unused credit facilities totaling $529 at December 31, 1985, are available for use by foreign subsidiaries.

In August 1983, the Company registered with the Securities and Exchange Commission $500 of debt securities, of which $200 has been issued.

Long-term Debt	1985	1984
Promissory notes		
8.00%, final maturity 1986		$ 120
4.50%, final maturity 1990	$ 40	45
5.00%, final maturity 1991	36	40
10.25%, final maturity 1992	100	
9.50%, final maturity 2015	200	
Debentures		
4.35%, final maturity 1988	9	11
6.70%, final maturity 1998	34	34
7.75%, final maturity 1999	42	42
8.85%, final maturity 1999	49	52
8.88%, final maturity 2000	62	62
8.90%, final maturity 2000	72	72
7.40%, final maturity 2002	43	43
7.63%, final maturity 2003	45	45
8.50%, final maturity 2005	162	162
8.50%, final maturity 2006	160	160
7.88%, final maturity 2007	241	241
8.63%, final maturity 2008	275	275
11.25%, final maturity 2010	400	400
Bonds		
11.25%, final maturity 1988, Kuwaiti dinar	17	17
8.50%, final maturity 1992, Japanese yen	91	79
9.63%, final maturity 1994, U.S. dollar	186	192
7.00%, final maturity 1994, Japanese yen	249	199
6.75%, final maturity 1995, Deutsche mark	122	
10.99%, final maturity 1997, Pound sterling	432	
Other facilities – Various rates and maturities		
Foreign currency loans	90	55
U.S. dollar loans	15	18
Pollution control/industrial revenue bonds	400	334
Unexpended construction funds	(119)	(75)
Capital lease obligations	55	59
Subtotal	3,508	2,682
Less unamortized debt discount	310	12
Total	$3,198	$2,670

N Stockholders' Equity

The authorized capital stock consists of 25 million preferred shares with a par value of $1.00 per share, none of which has been issued, and 500 million shares of common stock with a par value of $2.50 per share.

At December 31, 1985, 1984 and 1983, shares of common stock outstanding (in thousands) were 190,160; 190,092 and 195,846, after deducting 20,998; 18,522 and 10,703 shares of treasury stock, respectively.

Retained earnings of the parent company were approximately $2,129 at December 31, 1985, and there were no significant restrictions limiting the availability for dividend purposes.

Undistributed earnings of 20%-50% owned companies included in retained earnings were $476 and $432 at December 31, 1985 and 1984, respectively.

In computing earnings per share, no adjustment was made for common shares issuable under award, option and stock purchase plans because there would be no material dilutive effect.

Number of Issued Shares (in thousands)	1985	1984	1983
Beginning of the year	208,614	206,549	204,117
Sold to employees	2,544	2,065	2,432
End of the year	211,158	208,614	206,549

Reserved Common Stock (in thousands)	1985	1984	1983
Stock option and award plans	9,061	10,544	10,813
Employees' stock purchase plan	1,227	1,380	1,576
Total shares reserved	10,288	11,924	12,389

O Pension Plans and Postretirement Benefits

The Company and its subsidiaries have several retirement plans covering substantially all employees, including certain employees in foreign countries. The cost of all retirement plans was $150 in 1985, $124 in 1984 and $123 in 1983. The Company makes annual contributions to the plans equal to the amounts accrued for pension expense, as determined by the aggregate cost method of valuation.

The assumed rate of return used in determining the actuarial present value of accumulated benefits was 8% for 1986 and 1985. The actuarial assumptions used in determining the funding and pension costs for the principal domestic defined benefit plan for 1985 and 1984 included an 8% interest valuation rate, an annual compensation increase of 6%, an average retirement age of 62 and turnover based on experience.

The Company's foreign pension plans are not required to report pursuant to ERISA and have not determined for 1985 the actuarial value of accumulated benefits or net assets available for benefits as calculated and disclosed. However, as of January 1, 1985 and 1984, available assets in other plans exceeded vested benefits by approximately $81 and $100, respectively.

In addition to providing pension benefits, the Company and its subsidiaries provide certain health care and life insurance benefits to retired employees. Substantially all employees of the Company and its Canadian subsidiaries, including employees in a limited number of foreign subsidiaries, may become eligible for those benefits if they reach retirement age while working for a participating employer. The Company may modify these benefits at any time. The cost of retiree health care and life insurance benefits is recognized as an expense as benefits are paid; in 1985 and 1984 those costs totaled $27 and $21, respectively.

The chart shows a comparison of accumulated plan benefits and plan assets at January 1 for the Company's domestic defined benefit plans, representing more than 85% of accumulated pension plan benefits for the Company and its consolidated subsidiaries.

Accumulated Plan Benefits January 1	1986	1985
Actuarial present value of accumulated plan benefits:		
Vested	$1,446	$1,190
Nonvested	150	273
Total	$1,596	$1,463
Net assets available for benefits	$1,654	$1,314

P Stock Option and Award Plans

Stock option plans and management incentive awards are described in the Company's Proxy Statement of March 1986. Options under all plans are granted at market price of the shares on the date of the grants.

Aggregate amounts charged to expense for all plans were $14 in 1985 and $15 in 1984 and 1983.

The Company made offerings of common stock to its employees, excluding directors, in 1985 and 1984 at $24.00 per share and $24.80 per share, respectively, payable generally through payroll deductions. Unfilled subscriptions (in thousands), cancellable at the option of the employee, were 1,227 and 1,380 shares at December 31, 1985 and 1984, respectively. Partial payments on these subscriptions aggregating $18 and $20 at December 31, 1985 and 1984, respectively, are included in current liabilities.

Stock Transactions	1985		1984	
(in thousands)	Deferred Stock	Dividend Units	Deferred Stock	Dividend Units
Granted during year	114	112	128	587
Outstanding at December 31	717	1,517	658	1,408
Available for grant at December 31	2,578	2,786	2,679	2,896

Common Stock Under Option	1985		1984	
(in thousands)	Number Shares	Price Range	Number Shares	Price Range
Options expired or terminated during year	64		30	
Options exercisable at December 31	3,167		3,840	
Options available for grant at December 31	1,816		2,576	
Outstanding at December 31	3,950	$20.13-$36.13	4,630	$20.13-$36.13
Granted during year	787	29.19- 35.31	796	27.69- 29.88
Exercised during year	1,403	22.31- 35.31	100	22.31- 33.88

In addition, when the Company purchased FilmTec in 1985, FilmTec stock options were converted to 75 thousand equivalent Dow common stock options with a price range of $9.44-$27.50, of which 73 thousand were outstanding at year-end. These options will be fully vested over five years. Options exercised during the year and options exercisable at year-end were 2 thousand and 13 thousand, with price ranges of $9.44-$18.88 and $9.44-$27.50, respectively.

Q Commitments and Contingent Liabilities

The Company and its subsidiaries are parties to a number of claims and lawsuits arising out of the normal course of business with respect to commercial matters including product liabilities, governmental regulation including environmental matters, and other actions. Certain of these actions purport to be class actions and seek damages in very large amounts. All such claims are being contested. The amounts of ultimate liability thereunder are indeterminable at December 31, 1985. The Company is also a party to several lawsuits arising out of insurance policies issued to the Company and its subsidiaries. These lawsuits involve the recoverability under these insurance policies of certain losses and expenses incurred by the Company. In the opinion of management, resolution of these matters will not materially affect the consolidated financial position or results of operations of the Company and its subsidiaries.

As a general partner of several partnerships, the Company may be liable for any deficiencies which may arise in meeting the terms of loan obligations incurred by the partnerships. Assets of the partnerships which have been pledged as security for these loans are currently in excess of the loan obligations.

The Company has various purchase commitments for materials, supplies and items of permanent investment related to the ordinary conduct of business. Such commitments are not at prices in excess of current market. While certain of these commitments are for quantities in excess of the Company's present requirements, they are not expected to have any material adverse effect on the consolidated financial position or results of operations of the Company.

On July 14, 1983, the Company terminated the General Agreement with Consumers Power Company dated June 21, 1978, under which Consumers had agreed to supply process steam to Dow's Michigan Division upon completion of the Midland Nuclear Facility. Concurrently, Dow filed suit in Midland, Michigan Circuit Court seeking a declaratory judgment that all obligations of Dow with respect to the General Agreement are cancelled and discharged due to Consumers' wrongful conduct or, alternatively, if Dow's obligations have not been completely cancelled and discharged that any termination payment under the General Agreement be substantially reduced. Dow further seeks a declaration that it is owed damages arising from Dow's expenditures of more than $60 in reliance on Consumers Power's misrepresentations and nondisclosures as well as such additional relief as the Court deems proper. Consumers claims that Dow is obligated to pay a termination fee of $460, in addition to money damages for bad faith breach of contract. Trial commenced in Midland, Michigan Circuit Court on October 9, 1984, and with numerous scheduled recesses is still continuing. In the opinion of Dow and its legal counsel, the ultimate amount of any such liability is indeterminable at this time. Accordingly, Dow has not recorded any provision for possible loss on the contract termination.

A United Kingdom partnership has entered into a 15-year operating lease agreement for a semisubmersible drilling rig to be used for oil and gas drilling operations. A subsidiary of the Company is a 50% participant in the partnership, and the Company has severally guaranteed the lease payments to be made by the partnership. The guarantee amounted to $80 at December 31, 1985.

The Company receives funds periodically from the sale of financial instruments with full recourse, the amount of these recourse agreements was $110, outstanding at December 31, 1985, was $109.

A Canadian subsidiary has entered into two 20-year agreements to purchase substantially all the output of an ethylene plant (Plant No. 1) and 40% of the output of a second ethylene plant (Plant No. 2). The purchase price of the output is determined on a cost-of-service basis which, in addition to covering all operating expenses and debt service costs, provides the owner of the plants with a specified return on capital. Total purchases under the agreements were $153, $159 and $146 in 1985, 1984 and 1983, respectively.

The following table shows the fixed and determinable portion of obligations under such purchase commitments (at December 31, 1985 exchange rates) net of noncancellable sales commitments.

Fixed and Determinable Obligations

1986	$ 92
1987	89
1988	88
1989	86
1990	83
1991 – expiration of contracts	917
Subtotal	1,355
Less amounts estimated to represent interest	111
Total	$1,244

The owner of the plants, The Alberta Gas Ethylene Company Ltd. (AGEC), has borrowings outstanding of $185 which were used for the construction of Plant No. 1 and are guaranteed as to principal and interest by the Company. The Company has severally guaranteed the performance of its subsidiaries under agreements to purchase output of Plant No. 2 and to fund its share of any cash deficiencies (as defined in the agreement) in the plant's operating and debt service costs.

R Combined Financial Statements of Principal 50% Owned Companies

The summarized financial statements represent the combined accounts of principal companies in which Dow owns a 50% interest. Amounts presented include the assets, liabilities, revenues and expenses (until the dates of purchase or sale prior to year-end) of the following major international companies: Dow Corning Corporation, a manufacturer of silicone and silicone products; Dowell Schlumberger companies, which perform services for oil and gas wells; and MT Partnership, engaged in oil and gas activities.

The Company's equity interest in these companies was $837 and $800 in 1985 and 1984, respectively, and its interest in earnings was $132, $49 and $84 in 1985, 1984 and 1983, respectively.

Combined Balance Sheet	1985	1984
Current assets	$1,019	$1,002
Plant property – net	2,449	2,455
Other assets	53	51
Total assets	$3,521	$3,508
Current liabilities	$ 684	$ 646
Long-term debt	762	888
Other liabilities	209	179
Stockholders' equity	1,866	1,795
Total liabilities and stockholders' equity	$3,521	$3,508

Statement of Combined Income and Retained Earnings	1985	1984	1983
Sales	$2,317	$2,1[illegible]	$1,703
Cost of sales	1,749	1,481	1,103
Other expenses – net	215	433	357
Income before provision for taxes	353	192	243
Taxes on income	71	70	79
Net income	282	122	164
Retained earnings at Jan. 1	860	974	963
Dividends declared	(196)	(236)	(148)
Adjustment for divestitures			(5)
Retained earnings, end of year	$ 946	$ 860	$ 974

S Condensed Consolidated Financial Statements of Dow Financial Services Corporation and Subsidiaries

Consolidated Balance Sheet	1985	1984
Cash and due from banks	$ 664	$ 540
Marketable securities	288	176
Bills discounted	98	121
Loans and overdrafts	1,264	808
Other assets	167	135
Total assets	$2,481	$1,780
Demand and time deposits	$2,140	$1,541
Other liabilities	188	128
Stockholders' equity	153	111
Total liabilities and stockholders' equity	$2,481	$1,780

Consolidated Statement of Income	1985	1984	1983
Operating income	$249	$226	$177
Operating expenses	234	219	169
Profit before taxes on income	15	7	8
Taxes on income	3	2	
Net income	$ 12	$ 5	$ 8

Cumulative Translation Adjustments	1985	1984	1983
Beginning of year	$(30)	$ (9)	$ (1)
Current year translation adjustments	26	(21)	(8)
End of year	$ (4)	$(30)	$ (9)

T Industry Segments and Geographic Areas

The Company conducts its worldwide operations through separate geographic area organizations which represent major markets or combinations of related markets. Transfers between areas are valued at cost plus a markup. There were no direct sales to foreign customers from domestic operations.

Aggregation of products is generally made on the basis of process technology, end-use markets and channels of distribution. The Basic Chemicals segment embodies inorganic chemicals, organic chemicals and hydrocarbons and energy. The Basic Plastics segment is comprised of plastic materials and products. Industrial Specialties encompasses functional chemicals, polymeric materials and fabricated products. Consumer Specialties includes agricultural chemicals, human health care products and household films and cleaning products.

Transfers between industry segments are generally valued at standard cost. Dowell, which was a separate segment prior to the sale in 1984, accounts for the Unallocated. Depreciation related to industry segments includes costs associated with the special charges.

Industry Segment Results

Year		Basic Chemicals	Basic Plastics	Industrial Specialties	Consumer Specialties	Unallocated	Corporate and Elim.	Consolidated
1985	Sales to unaffiliated customers	$5,237	$1,506	$2,765	$2,029			$11,537
	Intersegment transfers	1,416	120	26	6		$(1,568)	
	Operating income	165	60	186	226			637
	Identifiable assets	4,762	1,079	2,206	1,645		2,138	11,830
	Depreciation	619	92	182	76	$ 8		977
	Capital expenditures	372	55	268	111			806
1984	Sales to unaffiliated customers	$5,337	$1,671	$2,583	$1,675	$152		$11,418
	Intersegment transfers	1,552	125	17	14		$(1,708)	
	Operating income	250	169	313	130	(26)		836
	Identifiable assets	4,968	1,095	1,582	1,513		2,205	11,363
	Depreciation	602	72	124	97	13		908
	Capital expenditures	397	82	211	87	4		781
1983	Sales to unaffiliated customers	$4,938	$1,613	$2,411	$1,496	$493		$10,951
	Intersegment transfers	1,511	116	16	14		$(1,657)	
	Operating income	145	79	307	59	(89)		501
	Identifiable assets	5,439	1,147	1,396	1,452	523	1,989	11,946
	Depreciation	521	77	109	77	57		841
	Capital expenditures	348	57	138	60	26		630

Geographic Area Results

Year		United States	Europe	Rest of World	Corporate and Elim.	Consolidated
1985	Sales to unaffiliated customers	$5,211	$4,100	$2,226		$11,537
	Transfers between areas	908	216	229	$(1,353)	
	Operating income	255	286	96		637
	Identifiable assets	6,197	2,939	2,570	124	11,830
	Gross plant properties	6,803	2,770	2,302		11,875
	Capital expenditures	506	168	132		806
1984	Sales to unaffiliated customers	$5,293	$3,845	$2,280		$11,418
	Transfers between areas	851	227	261	$(1,339)	
	Operating income	383	292	161		836
	Identifiable assets	6,073	2,588	2,658	44	11,363
	Gross plant properties	6,521	2,485	2,250		11,256
	Capital expenditures	433	203	145		781
1983	Sales to unaffiliated customers	$5,225	$3,568	$2,158		$10,951
	Transfers between areas	824	173	286	$(1,283)	
	Operating income	219	168	114		501
	Identifiable assets	6,547	2,602	2,731	66	11,946
	Gross plant properties	6,916	2,377	2,231		11,524
	Capital expenditures	386	139	105		630

SUPPLEMENTARY INFORMATION ON EFFECTS OF CHANGING PRICES
(unaudited)

Supplementary financial information, prepared in accordance with Statement of Financial Accounting Standards No. 33 and 82, Financial Reporting and Changing Prices, shows certain income data presented in the historical cost income statement on page 18 adjusted to current costs expressed in dollar values generally at the average 1985 price level.

Comparison of Selected Financial Data in Historical Dollars and Current Costs (dollars in millions, except per share amounts)	1985	1984	1983	1982	1981
Sales	$11,537	$11,418	$10,951	$10,618	$11,873
Adjusted for general inflation	11,537	11,824	11,824	11,833	14,043
Income before extraordinary items	$ 58	$ 524	$ 287	$ 264	$ 530
Current costs	31	462	111	51	187
Unrealized gain attributable to holding net monetary liabilities	$ 142	$ 154	$ 160	$ 196	$ 472
Earnings per common share before extraordinary items	$ .31	$ 2.70	$ 1.47	$ 1.36	$ 2.82
Current costs	.16	2.38	.57	.27	.99
Current costs including unrealized gain	.91	3.18	1.39	1.28	3.51
Stockholders' equity at year-end	$ 4,792	$ 5,040	$ 5,051	$ 5,051	$ 4,980
Current costs	6,820	7,749	8,875	9,620	10,664
Debt ratio (%) at year-end	43.2%	38.4%	40.8%	42.0%	46.5%
Current costs	34.0	29.3	29.4	29.6	31.8
Dividends declared per common share	$ 1.80	$ 1.80	$ 1.80	$ 1.80	$ 1.80
Adjusted for general inflation	1.79	1.86	1.94	2.00	2.12
Market price per common share at year-end	$ 41.00	$ 27.50	$ 33.38	$ 25.88	$ 26.25
Adjusted for general inflation	40.35	28.08	35.44	28.52	30.04
Increase in general price level of inventories and net plant over change in specific prices	$ 577	$ 785	$ 599	$ 591	$ 124
Average Index CPI-U (1967 = 100)	322.2	311.1	298.4	289.1	272.4

At December 31, 1985, the current cost for inventories was $2,170 (average inventory values approximated current cost) and net plant property was $7,101 (valued at chemical plant construction cost indexes). Current cost depreciation of $979 was calculated on a straight-line basis and historical depreciation of $977 was calculated using the double-declining balance method, both of which included the special write-off program.

PRODUCT SEGMENT SALES ANALYSIS
(unaudited)

Sales of Principal Products and Services (in millions)

		1985	1984	1983
Basic Chemicals	Inorganic chemicals	$1,633	$1,766	$1,654
	Organic chemicals	1,446	1,519	1,488
	Hydrocarbons	2,158	2,052	1,796
	Total Basic Chemicals	$5,237	$5,337	$4,938
Basic Plastics	Total Basic Plastics Materials	$1,506	$1,671	$1,613
	Total Basic Chemicals/Plastics	$6,743	$7,008	$6,551
Industrial Specialties	Functional chemicals	$ 423	$ 432	$ 408
	Polymeric materials	1,717	1,537	1,434
	Fabricated products	625	614	569
	Total Industrial Specialties	$2,765	$2,583	$2,411
Consumer Specialties	Agricultural chemicals	$ 678	$ 648	$ 547
	Human health	758	706	661
	Household products	593	321	288
	Total Consumer Specialties	$2,029	$1,675	$1,496
	Total Industrial/Consumer	$4,794	$4,258	$3,907
Unallocated	Unallocated – Dowell services		$ 152	$ 493

Principal Products and Services

Basic Chemicals	**Inorganic chemicals** *Caustic soda, calcium chloride, chlorinated solvents, chlorine, ethylene dichloride/vinyl chloride, hydrogen chloride, magnesium hydroxide, magnesium metal.*
	Organic chemicals *Acetone, alkanolamines, bisphenol,* Dowanol *glycol ether products, epichlorohydrin, ethyleneamines, ethylene glycol, ethylene oxide, glycerine, phenol, propylene glycol, propylene oxide, styrene monomer.*
	Hydrocarbons *Ethylene/propylene, feedstocks and refinery products, steam and power.*
Basic Plastics	**Plastic materials** Dowlex *linear low density polyethylene, high density polyethylene, low density polyethylene,* Styron *polystyrene resins.*
Industrial Specialties	**Functional chemicals** Dowex *ion exchange resins,* Dowfax *surfactants,* Dowicide *and* Dowicil *antimicrobials,* Dowtherm *heat transfer fluids,* Generon *hollow fiber membranes,* Methocel *cellulose ethers,* Separan *flocculant,* Versene *chelating agents.*
	Polymeric materials *Acrylonitrile-butadiene-styrene (ABS),* Calibre *polycarbonates,* Derakane *vinyl ester resins, epoxy resins,* Primacor *adhesive polymers,* Saran *resin and latexes, styrene-butadiene latexes,* Tyril *styrene-acrylonitrile resins,* Voranate *isocyanates and* Voranol *polyols.*
	Fabricated products Ethafoam *plastic foam, magnesium sheet, plate and extrusions,* Pelaspan-Pac *plastic lined pipe products,* Styrofoam *polystyrene foam,* Trycite *polystyrene film,* Zetabon *plastic and metal.*
Consumer Specialties	**Agricultural chemicals** Dowpon *grass killer,* Dursban *and* Lorsban *insecticides,* Lontrel *herbicide, phenoxy herbicides,* Plictran *miticide,* Telone *soil fumigant,* Tordon *and* Garlon *herbicides.*
	Human health *Artificial kidneys,* Cepacol *products,* Lorelco *hypocholesterolemic,* Nicorette *anti-smoking aid,* Novahistine *products,* Rifadin *and* Rifocin *antibiotics,* Seldane *and* Teldane *antihistamine.*
	Household products DOW *Bathroom Cleaner,* Fantastik *all-purpose cleaner,* Glass Plus *glass cleaner,* Handi-Wrap *plastic film,* Pine Magic *multi-purpose cleaner,* Saran Wrap *plastic film,* Spray 'n Wash *laundry stain remover,* Tough Act *cleaner,* Vivid *bleach,* Yes *laundry detergent,* Ziploc *bags.*

ELEVEN-YEAR SUMMARY OF SELECTED FINANCIAL DATA

(in millions, except per share data)		1985
Summary of operations	Net sales	$ 11,537
	Cost of sales[4]	9,615
	Selling and administrative	1,285
	Operating income[4]	637
	Investment and sundry income (expense)	(301)
	Interest expense – net	(306)
	Income before provision for taxes[4]	30
	Taxes on income[4]	(28)
	Income before extraordinary items and cumulative effect of accounting change[4]	$ 58
	Per share of common stock (dollars)[1]	
	Income before extraordinary items and cumulative effect of accounting change[4]	$ .31
	Cash dividends paid per share	$ 1.80
	Average commen shares outstanding (thousands)[1]	190,386
Year-end financial position	Total assets[4,5]	$ 11,8[illegible]0
	Working capital[4]	1,349
	Property, plant and equipment – gross	11,875
	Property, plant and equipment – net	5,127
	Long-term debt[5]	3,198
	Total debt[5]	3,661
	Stockholders' equity[4]	4,792
Financial ratios	Research and development expense as percent of sales	4.7%
	Income before provision for taxes as percent of sales[4]	.3%
	Return on average stockholders' equity[4]	1.2%
	Book value per common share[1,4]	$ 25.85
	Borrowings as a percentage of total capital invested[4,5]	43.2%
General	Capital expenditures	$ 806
	Depreciation	977
	Research and development expenses	547
	Total taxes[2,4]	270
	Wages and salaries paid	1,663
	Cost of employee benefits[2]	387
	Number of employees at year-end (thousands)	53.2
	Market price of common stock[1]	
	High	$ 41.88
	Low	27.00
	Close on December 31	41.00
	Number of stockholders at year-end (thousands)	122.6

[1] *Adjusted for stock splits.*
[2] *FICA tax is included in total taxes and cost of employee benefits.*

1984	1983	1982	1981	1980	1979	1978	1977	1976	1975
$11,418	$10,951	$10,618	$11,873	$10,626	$ 9,255	$ 6,888	$ 6,234	$ 5,652	$ 4,888
9,528	9,461	9,392	10,073	8,649	7,231	5,284	4,734	4,125	3,398
1,054	989	952	938	765	690	552	480	431	413
836	501	274	862	1,212	1,334	1,052	1,020	1,096	1,077
170	248	363	254	315	237	144	126	97	135
(343)	(318)	(406)	(430)	(298)	(272)	(237)	(220)	(161)	(108)
663	431	231	686	1,229	1,299	959	926	1,032	1,104
139	144	(33)	156	424	515	384	372	420	474
$ 524[3]	$ 287[3]	$ 264[3]	$ 530	$ 805	$ 784	$ 575	$ 554	$ 612	$ 630
$ 2.70[3]	$ 1.47[3]	$ 1.36[3]	$ 2.82	$ 4.42	$ 4.33	$ 3.16	$ 3.00	$ 3.30	$ 3.40
$ 1.80	$ 1.80	$ 1.80	$ 1.80	$ 1.66	$ 1.45	$ 1.25	$ 1.10	$ .90	$ .73
193,795	194,999	193,224	187,961	182,162	181,149	182,091	184,354	185,412	185,205
$11,363	$11,946	$11,768	$12,503	$11,600	$10,252	$ 8,789	$ 7,752	$ 6,944	$ 5,942
1,274	1,301	1,776	1,934	1,649	1,138	1,165	874	744	766
11,256	11,524	11,199	10,984	9,873	8,909	8,038	7,158	6,171	5,104
5,173	5,695	5,961	6,174	5,672	5,236	4,762	4,277	3,649	2,885
2,670	2,734	3,409	3,864	3,438	3,055	2,937	2,473	1,998	1,384
3,154	3,498	3,685	4,360	4,174	3,656	3,398	3,056	2,506	2,042
5,040	5,051	5,051	4,980	4,563	3,897	3,395	3,097	2,847	2,432
4.4%	4.5%	4.3%	3.4%	3.0%	2.9%	3.4%	3.3%	3.3%	3.4%
5.8%	3.9%	2.2%	5.8%	11.6%	14.2%	14.1%	14.9%	18.4%	22.7%
11.1%	6.5%	6.4%	11.1%	19.0%	21.5%	17.7%	18.6%	23.2%	28.8%
$ 26.55	$ 25.79	$ 25.83	$ 25.20	$ 23.15	$ 21.51	$ 18.74	$ 16.95	$ 15.35	$ 13.12
38.4%	40.8%	42.0%	46.5%	47.5%	48.2%	49.7%	49.3%	46.4%	45.2%
$ 781	$ 630	$ 829	$ 1,176	$ 1,184	$ 1,268	$ 1,075	$ 1,163	$ 1,200	$ 935
908	841	870	806	728	634	562	493	420	364
507	492	460	404	314	269	232	203	188	167
396	444	271	460	679	748	572	550	597	636
1,548	1,627	1,668	1,675	1,468	1,301	1,113	976	888	791
382	381	390	361	339	297	263	224	205	171
49.8	54.5	56.6	63.8	56.8	55.9	53.5	53.2	53.0	53.1
$ 34.50	$ 38.38	$ 28.88	$ 39.00	$ 39.25	$ 34.88	$ 30.88	$ 43.50	$ 57.25	$ 47.75
25.75	25.00	19.63	23.38	28.25	24.38	22.00	25.25	38.38	26.88
27.50	33.38	25.88	26.25	32.13	32.13	24.88	26.75	43.38	45.81
133.7	136.4	144.[illegible]	143.6	137.0	141.5	136.7	125.4	112.3	98.2

[3] Extraordinary items, net of tax, were an addition to net income of $36, or $.19 per share, in 1984; $41, or $.21 per share, in 1983; $57, or $.30 per share, in 1982.
[4] Years 1981 through 1984 have been restated to reflect the inventory accounting change from LIFO to FIFO for most foreign inventories.

[5] Prior years' unexpended construction funds from revenue bond borrowings and their associated interest income have been reclassified to long-term debt and interest expense in the years 1981 through 1984.

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The Dow Chemical Company
Midland, Michigan 48674

ATTCHMENT D

Certification of Operating and Decommissioning Funds

DOW CHEMICAL U.S.A.

MIDLAND, MICHIGAN 48674

November 13, 1986

Director, Office of Nuclear Reactor Regulation
U.S. Nuclear Regulatory Commission
Washington, D.C. 20555

DOCKET NO. 50-264

Dear Sir:

The Dow Chemical Company certifies that it will provide the funds necessary for the operation and for the eventual decommissioning of the Dow TRIGA Research Reactor.

Very truly yours,

THE DOW CHEMICAL COMPANY

By: I. G. Snyder, Jr.

I. G. Snyder, Jr.
Vice President
Director of R&D
Dow Chemical U.S.A.

Sworn to and subscribed before me by the above person on this date November 17, 1986.

Janet G. Gary
Notary Public

JANET G. GARY
NOTARY PUBLIC, MIDLAND COUNTY, MICHIGAN
MY COMMISSION EXPIRES MAY 1, 1988