



Linde plc 3Q22 Earnings Teleconference and Webcast - Transcript

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Corporate Participants

Juan Pelaez - Vice President Investor Relations

Sanjiv Lamba - Chief Executive Officer

Matt White - Executive Vice President and Chief Financial Officer

Analyst Participants

Peter Clark - Société Générale

Duffy Fischer - Goldman Sachs

Stephen Richardson - Evercore

Stephen Byrne - Bank of America

Michael Leithead - Barclays

Nicola Tang - Exane BNP Paribas

Jeff Zekauskas - JPMorgan

David Begleiter - Deutsche Bank

Vincent Andrews - Morgan Stanley

Daniel Rizzo - Jefferies

Geoff Haire - UBS

John Roberts - Credit Suisse

Cory Murphy - Vertical Research Partners, LLC.

Mike Sison - Wells Fargo Securities

Mike Harrison - Seaport Global Securities

Presentation

Speaker 0-Operator

Good day and thank you for standing by. Welcome to the Linde plc Third Quarter 2022 Earnings Teleconference. At this time, all participants are in a listen-only mode. Please be advised that today's conference is being recorded. And after the speakers' presentation, there will be a question-and-answer session.

I would now like to hand the conference over to Mr. Juan Pelaez, Head of Investor Relations. Please go ahead sir.

Speaker C-Juan Pelaez

Thank you, Cecelia. Good morning everyone and thank you again for attending our 2022 third quarter earnings call and webcast. I am Juan Pelaez, Head of Investor Relations. And I'm joined this morning by Sanjiv Lamba, Chief Executive Officer; and Matt White, Chief Financial Officer.

Today's presentation materials are available on our website at linde.com in the investors' section. Please read the forward-looking statement disclosures on Page 2 of the slides and note that it applies to all statements made during this teleconference. The reconciliations of the adjusted numbers are in the appendix to this presentation. Sanjiv will provide some opening remarks and then Matt will give an update on Linde's third quarter financial performance and outlook. After which we will wrap up with Q&A.

Let me now turn the call over to Sanjiv.

Speaker C-Sanjiv Lamba

Thanks Juan and good morning everyone. Linde employees once again delivered a strong quarter despite the economic challenges. EPS increased 21%, excluding FX, while operating margins expanded 90 basis points when adjusting for contractual cost pass-through. All underpinned by \$2.6 billion of operating cash flow and a record ROC of 21.8%. Now in addition to achieving this financial performance, the company recently received approval for its absolute emission reduction target by the Science Based Targets initiative, confirming our roadmap to help de-carbonize the planet. I'm pleased to see these results, which are truly a testament to the quality of our team and our relentless execution culture.

These financial results highlight both the resilient and growth capabilities of the business in any environment. In times like these, it's important to remind investors of our stable and diversified growth trends, which you can find on Slide 3. We continued to experience robust underlying sales growth this quarter with each business segment growing double-digit versus last year. Resilient end-markets, which make up about one-third of sales are collectively growing double-digit percent with food, beverage and electronics up almost 20%, and healthcare slightly down from prior year pandemic volumes.

Our gases are critical for the production and packaging of everyday consumer items such as food, carbonated beverages, respiratory applications and electronic components. These volumes track to broad consumption levels rather than specific technologies or trends. So they are quite stable even during volatile economic periods. Furthermore, despite what you may be reading in the news, we continue to see healthy supplies of gases into electronics fabs in every region. In fact our total electronics project backlog increased to \$1.4 billion after recently being awarded a second large sale of gas contract for a major semiconductor manufacturer in the US.

The bottom half of the table provides the trends for the more cyclical end-markets. And similar to electronics these trends probably don't align with what you are hearing and reading. Recall that a significant portion of these sales are underpinned by fixed payment structures, independent of customer volumes including on-site fees and cylinder rentals. It's important to note that we spent a lot of time on contract language to ensure our returns are protected and force majeure clauses are absolutely clear. I won't speak for the industry, but I have confidence in the strength of Linde contracts. We've demonstrated this through countless regional and global challenges including the most recent pandemic, and so, I don't see today being any different.

In addition, a large portion of our customers represent the most competitive in their markets with assets that tend to be the last ones running. Our disciplined long-term approach to capital allocation continues to be validated during these challenging times. At almost 60% of sales, the cyclical end-markets are also up double-digit percent. While growth is broad-based we continue to see strength in mining for battery material, merchant hydrogen sales, aerospace including commercial space and general manufacturing especially in Americas. In fact the US continues to be our best growth market as a combination of natural resource security, consumer resiliency and a strong dollar to support further economic expansion.

This is especially true for the Gulf Coast, which is experiencing one of the highest investment activity in quite some time, driven by lower cost energy and the ability to economically de-carbonize with the passage of the US Inflation Reduction Act or IRA, which you can find on the next Slide 4. The IRA has accelerated significant growth prospects from an unrivaled hydrogen and atmospheric gas network as well as potential new markets being developed across the US. To this effect we've grouped these activities into three different categories of de-carbonize Linde, de-carbonize customers and new markets.

Let me start with de-carbonize Linde, which represents the ability to sequester existing CO2 emissions generated from our own hydrogen production. This provides simultaneous benefits. The production and supply of blue hydrogen into our network and the reduction of Scope 1 emissions per our stated sustainability goals. The potential investment to de-carbonize Linde exceed \$3 billion, while considering our existing hydrogen production asset base. The second category of de-carbonize customers represents two separate opportunities. The first to enable our customers to de-carbonize their processes through fuel switching, that is by using low-carbon intensity hydrogen as fuel in their refineries, crackers or furnaces. The second opportunity is our ability to capture and sequester existing carbon emissions from customers currently connected to our pipeline network, especially in the Gulf Coast.

This will be a revenue model similar to our current on-site business, and customers would benefit by de-carbonizing their own operations in addition to monetizing tax credits over the contract period. Together our potential investment in this category could easily exceed \$10 billion, which I view to be on an accelerated path given the incremental IRA benefit and the strength of Linde's existing network and asset base to support it. The third category of new markets represents greenfield opportunities that are starting to materialize with the signing of the IRA. And I expect to announce some new project wins very soon.

These too will be similar to our current on-site business with fixed payment contracts and stable returns. We estimate more than \$20 billion of potential investment with some of the larger ones related to blue and green hydrogen and blue ammonia. Regardless of which projects are pursued, we plan to follow a few overarching principles. The first, we intend to partner with subsurface experts for all underground operations. We at Linde are not geologists. Second, all projects will follow our investment criteria, in other words earn a commensurate return for the risk undertaken. Third, we will stick to our core, which is management of industrial gases. We have no interest to own or speculate on globally traded chemicals, rather we have offtakers for our products.

Finally it's important to understand the nature of the tax credits in the IRA. While the first 5 years are direct pay, essentially like grants, years 6 through 12 are tax credits that must be used against our US tax liability up to a cap. Therefore it's important for us to have an understanding on the monetization of these tax credits as we develop these projects whether use by Linde or sold to a third-party. Of course, we won't speculate on the market value of excess tax credits over the next decade. The IRA has accelerated the US clean-energy transition, and from what we are seeing today, the total investment opportunity for Linde in the US alone exceeds \$30 billion over the next decade.

Overall, I'm very bullish on the clean energy opportunities in front of us. And I expect to announce meaningful projects in the near-term. This secular growth driver coupled with our operating discipline and relentless focus on pricing and productivity within our base business is what gives me the confidence in our ability to keep delivering 10 plus percent EPS growth over the next several years.

I'll now turn the call over to Matt to walk you through the financial numbers.

Speaker C-Matt White

Thanks, Sanjiv. Please turn to Slide 5 for an overview of the third quarter results. Sales of \$8.8 billion grew 15% over last year and 4% sequentially. Cost pass-through, which represents the contractual billing of higher energy costs reached 8% year-over-year as energy prices continued to escalate. As a reminder this is merely a contractual gross-up and has no effect on operating profit dollars but will dilute operating margins. This is mostly offset by unfavorable currency translation of 7% as the US dollar has strengthened against every major currency. Divestiture headwind of 1% is from the Russian de-consolidation. And the 4% growth in engineering relates to favorable timing of project billing.

Excluding these items underlying sales increased 11% over 2021. Volume expanded 3% as one-third came from the project backlog and the remainder from increases in Americas and APAC. Partially offset by slightly lower volumes in EMEA. Pricing of 8% continues to be strong as all regions around the world are taking proactive and sustainable actions to recover inflation. Underlying sequential growth of 3% is driven by similar factors as broad-based price improvements and volume growth in Americas and APAC more than offset weaker volumes in EMEA from a combination of macroeconomic conditions and normal seasonal factors.

Operating profit of \$2 billion resulted in a 22.8% margin, which is 90 basis points above last year when excluding the effects of cost pass-through. Sequentially operating margins ex pass-through declined 20 basis points from both weaker volumes and a lag effect of merchant and package pricing in EMEA. We still expect consolidated operating margin ex pass-through to expand more than 100 basis points for the full year. EPS of \$3.10 increased 14% over prior year or 21% when excluding currency. This represents the eighth quarter in a row of EPS ex FX growth exceeding 20%, demonstrating the breadth of Linde's portfolio.

Return on capital of 21.8% reached another record from double-digit percent profit growth over a stable capital base. Our unrivaled asset network across all three supply modes enables industry-leading growth without significant capital intensity. Although we have ample capacity for greater investments of which we expect to announce large wins in the near future. The ROC trend is also a result of disciplined capital and cash management. Sanjiv mentioned how we intend to approach clean energy investments no different than other opportunities, which is an integral part of our multi-decade successful track-record. Our owners expect stable long-term returns commensurate with risk, making ROC one of the most important metrics in our industry.

Slide 6 provides more details on the third quarter capital management. Cash flow continues to be a key indicator of a company's stability and longevity, especially against the current backdrop of geopolitical uncertainty and rising interest rates. You can see operating cash flow trends with Q3 being the highest of 2022, up 24% sequentially and 3% from last year. In addition available cash flow, which we define as operating cash flow less base CapEx remains steady at \$1.5 billion to \$2 billion per quarter. Recall that base CapEx represents all non-project investments, of which approximately half are dedicated to growth initiatives.

The right part of the slide shows how we deployed year-to-date cash flow. As a reminder our capital allocation policy is simple and stable. We have a mandate to maintain an A credit rating while growing the dividend each year. Our priority is to invest in core business opportunities that meet our criteria. And any leftover cash is used for stock repurchases. Currently our metrics are better than a single-A credit rating. And thus we are actively recapitalizing the balance sheet. Year-to-date investments have totaled \$2.4 billion between CapEx and acquisitions, of which I anticipate an acceleration based on the current set of opportunities. Finally we've returned \$6.3 billion back to shareholders in the form of dividends and stock repurchases. An increase of 31% from last year. So this slide clearly demonstrates that irrespective of the macro climate, Linde will continue to drive steady, long-term quality growth while sharing a substantial portion with our owners each year.

I'll wrap up with guidance on Slide 7. For the fourth quarter EPS is anticipated to be \$2.80 to \$2.90 or 9% to 13% growth excluding an estimated 8% currency headwind. This represents a \$0.25 or 8% sequential decline from Q3 to the mid point. There are three major assumptions driving this. First, 4% of the decline is driven by engineering project timing. Engineering results are naturally lumpy due to project progress. And we had a sizable Americas project billing in Q3. And while the engineering business has been streamlining the organization and rebuilding the backlog to maintain strong competitiveness and quality results, I still expect Q4 to have lower sales and profit from this timing.

Second, we anticipate currency rates to worsen dragging down sequential EPS by another 2%. Rates seemed to stabilize in October, but we'll have to wait until January to see where they ultimately finish. Finally, we completed the divestiture of the non-core GIST business at the end of September. This had a minor effect at 1%, but we provided more details in the appendix, so you can better model the future impact. Note we are also assuming no base growth at the top-end of Q4 guidance, and thus recessionary conditions at the midpoint. Consistent with prior quarters, this economic assumption is merely a placeholder. So if conditions are better, we'll do better, and if they're worse, we'll take actions to mitigate.

The full year guidance of \$11.93 to \$12.03 represents 17% to 18% growth from last year when excluding currency. The midpoint of the range is \$0.15 higher than last quarter driven by better Q3 results. Overall the Linde team continues to execute despite the global challenges. We've demonstrated resilient, high-quality performance to recessionary conditions and 2023 will be no exception. So regardless of what you read in the news, you can count on Linde to deliver.

I'll now turn the call over to Q&A.

Questions And Answers

Speaker O-Operator

Thank you. (Operator Instructions). We will now take our first question from Peter Clark from Societe Generale. Please go ahead.

Speaker A-Peter Clark

Yes, good afternoon everyone or good morning, sorry. You call out good inflation management across the gaseous regions. And I know you brought in White Martins team I think over a year-ago to try and teach best practice. Just wondering what you added for that and how you think it gave you an advantage or a heads-up against the competition in this price inflation environment? Thank you.

Speaker C-Sanjiv Lamba

Peter, there are two things that I'd say that happened as a consequence of inflation coming through. You might recall Peter that very early in the process we said that we were looking at inflation and working through it, not believing it's transitional. I think that's obviously been proven now. And we brought in the LATAM teams as one example of best practice within the Group, shared that more broadly. The difference that lies over here, Peter is, all about execution. And you know we have a relentless execution culture, that's what drives that pricing every day.

You know as well that our performance culture requires that every month we sit-down and review the progress that's been made. And that cadence of operating rhythm of doing that is the other piece that I think drive pricing as we look at it. Decisions are made every day, they're not made every week or every month, because they know that at the end of the month we have to have a conversation about the decisions we made and any deviation that come out of that. It is really under-driven by or underwritten by the performance culture of the organization.

Speaker A-Peter Clark

And can I sneak in a little one. On the European smaller customer, medium-sized customer, industrial customer, are you seeing any change in behavior at all because we've had other companies getting quite concerned about how these small customers are suffering in the current environment.

Speaker C-Sanjiv Lamba

Peter, as I -- there are a couple of ways to address that. As I look at the different end markets and obviously we are paying a lot of attention to the medium and small-sized customers across Europe, there are two factors that we particularly look at. One is, what's happening to receivables, and I can confirm to you that cash generation receivables remain within expectation, which I think is a very important indicator as to how the markets are currently responding. I'm not going to predict what's likely to happen in the next quarter or beyond. But I can say for now that I think we've seen that accounts receivable reflect certain amount of resilience across that customer base as well.

The other piece I just mentioned to you is when you look at EMEA volumes, and I know you see a minus three over there. If you strip out the significant pandemic impact that came out of the healthcare, for most other end-markets volumes remained reasonably stable. Yes, they've softened a little, but they remained reasonably stable. And that includes the small and medium-sized customers as well.

Speaker A-Peter Clark

Got it. Thank you very much.

Speaker O-Operator

We will now take our next question from Duffy Fischer from Goldman Sachs. Please go ahead.

Speaker A-Duffy Fischer

Yes, good morning guys. Just a couple of questions around your Slide 4 and the Inflation Reduction Act. So first, if you look out maybe two or three years, how much can it absolutely grow your backlog do you think, what kind of bogey should we have for backlog increase? Second, what percent of that do you think will end-up being sale of gas versus sale of plant? And then just the last one, relative to the size of your typical projects historically, what do you think the average size of the projects around the IRA will be?

Speaker C-Sanjiv Lamba

Thanks Duffy. Let me start-off with the backlog question first. As you will recall, Duffy, in the past calls I've talked about a probability-weighted number of about 5 billion, that's obviously a global number. Today when I look at that number, that's trending close to 7 billion to 9 billion. Remember we tend to be quite conservative. These are decisions in the next 2 years to 3 years. And I'm expecting something of the order of 7 billion to 9 billion in actual decisions around projects in the next couple of years related to this, obviously accelerated in part by the IRA. Those decisions will obviously then end-up in the backlog given the size of these projects.

As far as sale of gas and sale of plant is concerned, we have in this -- in our industry we have the unique advantage of being able to do both, capability to execute both, and ensure that both of them actually enhance our returns. So from that perspective, that optionality is something that I certainly want to keep. And I want to make sure that we work our way through the quality of the projects, the risks associated with that before we make that final call. Our customers and developers recognize that, and actually appreciate the fact that we have that flexibility to offer as well.

So, I'm not going to give you a kind of percentage in terms of what you see out of sale of gas versus plant. It is fair to say as a principal though, that principally we like sale of gas as the base model. And it's where we find that the risks are probably a little bit different to what we would expect, that's where we would opt-out then for the sale of plant model. Largely on size of projects, I say to you, as you look at this number of 30 plus billion that we're talking about, you're going to see projects probably 20 to 25 large projects happen to make up that number. That kind of gives you a bit of an average view. There is no particular size that I can attribute to this project. They range depending on the scope of the project itself.

Speaker A-Duffy Fischer

Terrific. Thank you guys.

Speaker O-Operator

We will now take our next question from Stephen Richardson from Evercore ISI. Please go ahead.

Speaker A-Stephen Richardson

Hi good morning. I appreciate the comments on limiting your expertise to industrial gases and limiting some of the exposure in the subsurface. Couple of questions on that, where would your scope of CapEx end in these projects, Sanjiv, in terms of how you're thinking about them in a gray to blue kind of hydrogen setup? And then also do you think that though -- that subsurface partner needs to be part of the project consortium or is this something you think you can secure for a fee?

Speaker C-Sanjiv Lamba

Thanks Steve. So let me talk about the scope first. So typically carbon capture is absolutely within our scope in almost every instance, that is capability that we bring. There is proprietary technology that we are pushing hard at the moment. We think we've got some world-leading technology that we call high CO₂ PSAs, these are CO₂ PSAs that absorb that CO₂ capture rate and allow us to then take it forward for storage and sequestration. So quite excited and that's a part of the technology that we want to make sure we'll always be within that scope. Beyond that, ensuring that you pressurize and transport that CO₂ is something that we also would like to do typically, but are more flexible on. It's part of the scope that we would obviously give to our partner would be all-around that CO₂ going down-hole and what happens to that CO₂ beyond that including monitoring in longer-term et cetera.

As far as the approach to sub-surface partnerships are concerned, there are various models, Steve, that we would follow. There's a whole range from consortium approach that we've been working on already. And hopefully we'll announce in the near-term to having them as being partners, joint-venture partners within the project itself. So that whole range is available to us. We find that depending on the market and the actual project scope that, that kind of best defines where that partnership is then put together.

Speaker A-Stephen Richardson

That's great. And if I can have a quick follow-up just on how you're thinking about the de-carbonized customers? And again we appreciate all the detail here. But if we think about on-site in the Americas for example in hydrogen, is it right to think that you've got a natural jump-off point at the end of contracts where you can start opening the conversation about, okay, can we convert this to a blue project, a blue hydrogen project and what that looks like? Or is the incentive now so high that the customers are coming to

you saying, can we work together on some interim solution? Just curious what the contract tenure if anything could mean for the timing of this build-out?

Speaker C-Sanjiv Lamba

Steve it's definitely the latter where a number of customers are very actively engaged in conversations with us. What tends to happen is you have to think about this as an incremental service offer, if you like, on an existing asset. When we talk about de-carbonize Linde as an example that's where we would capture CO2 of our existing facilities and transform that gray hydrogen of today into blue hydrogen that goes into the network and feeds existing customers. So that's kind of one way to think about it. And that's where we're seeing a number of customers quite interested given the strength of our network and the asset footprint that we have in the US Gulf Coast.

In addition to that there will be conversations for sure that happened, it just depends on the timing of the contracts in many cases. The underlying take-away from this that I want you to kind of keep in mind is, there is urgency in the customer base to want to progress given that both 45Q and 45V in many ways is actually pushing them to try and monetize the benefit that comes out of this de-carbonization kind of effort that IRA is supporting.

Speaker A-Stephen Richardson

Thanks so much.

Speaker O-Operator

We will now take our next question from Steve Byrne from Bank of America. Please go ahead.

Speaker A-Stephen Byrne

Yes, thank you. I recall Sanjiv, you making some comments during the summer about what at least I perceived you had as kind of a longer-term estimate of the production cost for gray, blue and green hydrogen. And I recall it being gray \$1 a kilogram, \$1.50 for blue, \$4.50 for green. Perhaps I didn't hear that correctly, but that was all pre-IRA, and I would suspect your Niagara Falls project might actually have cost structure below that \$4.50. So post IRA, these three look like they're getting pretty close. Would you share that view? And where do you see the most incremental demand in development right now? Is it -- the blue seems like a bit of a layup for your pipeline customers, but where do you see the demand for green coming from?

Speaker C-Sanjiv Lamba

Right. Steve you've got good memory or good notes as the case might be. So it was \$1.30 for gray, \$1.50 for blue and about \$4.40 for green that are offered I think a couple of quarters ago. And that was all, I think natural gas price if I'm not wrong of around \$3.50. Obviously natural gas prices changed along the way as well. But the moot point over here that you make and I will validate for you is, gray and blue are coming close to parity today with the benefit of the 45Q in place. They are almost at parity I would say. As far as green is concerned with the 45V, the \$3 a kg is pretty attractive. The issue with green remains scalability.

And I'll talk a bit more about blue and green in that context, but from a cost point of view, that \$4.40 is now trending anywhere between \$2.50 to \$3. So it has come down substantially, but again because of lack of scale and the availability of cheap renewable energy, that pricing for green remains a little bit higher than what I would see as long-term inflection point, which you've heard me talk about \$1.50 as a long-term inflection point for us to see huge acceleration happen. Not quite there, but certainly heading in the right direction as far as we're concerned.

Coming onto where I see this development moving and really I think for me, blue today is available at scale, it's technology that's tested, and it's an offering that's available in the market today, which is why a lot of the conversations I referenced in my previous answer are being driven because that ability is available today. The challenge with green remains the ability to scale up and get access to reliable renewable energy at reasonable costs. That combination isn't quite here. And while the 45V out of the IRA gives some really good incentive, at its max \$3 per kg of green hydrogen, unfortunately the impediment really is around scale-up to getting that to a point of inflection and significant exploration.

So you summarize that, I expect a decade plus of blue as a great bridge to ultimately large-scale, industrial scale green, which is reliably available at cost where that conversion makes a lot of sense.

Speaker A-Stephen Byrne

Thank you.

Speaker O-Operator

We will now take our next question is from Mike Leithead from Barclays. Please go ahead.

Speaker A-Michael Leithead

Great. Thanks. Just three quick ones for Matt. I think you made a comment about recapitalizing the balance sheet, and since EBITDA is growing, I'm assuming that should mean buybacks should be growing faster from here. I guess one, is that correct? Two, what's the ideal leverage ratio obviously staying within your kind of credit parameters you'd like to be at. And maybe three, just a quick housekeeping, do you include buyback benefits in your 4Q guidance or is that just using a third-quarter share count?

Speaker C-Matt White

Hi Mike. So taking them in order. Yes, you are correct, recapitalize the balance sheet essentially means, you know, essentially reduce our equity through buybacks. And that would imply the debt building up. So that is absolutely correct. As far as the ideal leverage ratio, again you are correct, the single-A under the S&P scale and A two under Moody's is what we are aiming for. And as you know they do have their own proprietary metrics, which rely on certain adjustments for things like capitalized leases and pensions. But when looking at, what I call the simplified metric that we use, which today we're showing up 1.1 times on a debt-to-EBITDA, I think you can get that in the mid twos or higher as options and we've seen that in the past, clearly you have to work with the rating agencies to ensure your rates -- your ratings are still aligned, but I think that is definitely a feasible area.

And then as far as guidance, yeah, generally when we look at that, we sort of take that on kind of our share count. There might be a little bit of benefit of some of the buyback but realize as you know probably the buyback the way it affects into the EPS it's sort of a cumulative effect. So what you're doing in any given quarter tends to have more of a lag effect anyways. So it would more be a function of what we've done to now and maybe a little bit of what we do in the fourth quarter. And then what we do in the fourth quarter will have a bigger impact in Q1 and going forward. So there'll be a little bit in there. But it will be more a function of what we completed here in the third quarter.

Speaker A-Michael Leithead

Great. Thank you.

Speaker O-Operator

We will now take our next question from Nicola Tang. Your line is open. Please go ahead.

Speaker A-Nicola Tang

Just to ask a little bit about the buy, I'm sorry the stock up contribution into 2023. Could you confirm that Exxon is still on track for next year? And I think you talked about a 1% sort of volume impact in Q3. Can you give us a steer on what we should expect for next year? Thank you.

Speaker C-Sanjiv Lamba

Nicola, I didn't get the question entirely. But I heard Exxon and sale of gas for next year. And I wanted to just confirm to you that, that project is progressing on track. And we expect to have that from a commercial structure in place for next year. And you'll see that reflected next year as well.

Didn't get the second part of your question, Nicola.

Speaker A-Nicola Tang

I was just asking for the overall project start up contribution in 2023.

Speaker C-Sanjiv Lamba

Right. We expect to see a similar start up contribution, obviously up by what we see from an Exxon perspective, which is a single large project that you would see. But you should expect -- excluding that you should expect the same level of startups next year as this year, which we said earlier on was about \$1 billion of start ups in the course of this year.

Speaker A-Nicola Tang

Got it. Thank you.

Speaker O-Operator

We will now take our next question from Jeff Zekauskas from JPMorgan. Please go ahead.

Speaker A-Jeff Zekauskas

Thanks very much. In the third quarter sequentially did your price versus raw materials, did that margin widen out or did it shrink? And can you speak to the effect of higher interest rates on Linde and its interest expense or its returns over time?

Speaker C-Sanjiv Lamba

Jeff, I'll take the first question and ask Matt to talk you through what we're seeing on the interest side of things. So the way to kind of best describe it is, as you will see sequentially our margins in the Americas improved, APAC was stable and slightly up, and we did have a lag in the EMEA region, which obviously you've seen as well. We put a table on the EMEA slide just to explain that. So yes, as far as sequentially our recovery was more than offsetting inflation and Americas and APAC were able to reflect that. We are seeing some record pricing there.

In EMEA we had record pricing of 14%, this obviously excludes any pass-through. 14%, but despite that there is a lag. We were seeing electricity price increases in EMEA, in Germany and UK in 80s and 60% and that lag will be there for a month or so as you've seen from previous quarters. And I fully expect the team in EMEA is very conscious of that and working through both pricing and cost actions to make sure we have recovery as we move forward.

Speaker C-Matt White

And Jeff, this is Matt. So on the interest expense, maybe I can provide a high level answer and then get to your specific question. So when thinking about, I'd say, modeling interest expense, there's really two components to think about. One is going to be essentially what you're referring to, which is our current debt structure -- net debt structure, so the cash, the debt whether it's variable or fixed and then the interest effect on that both as interest income and interest outflow. But secondly, we do have some FX volatility that always occurs in our interest line. Some is related to the derivatives we have in inter-company loans, this would be the points that you may have that move up and down based on currencies. But the bigger volatility will actually be un-hedged inter-company loans where they get mark-to-market to the interest line based on whatever the prevailing interest rates are.

So they do tend to create volatility on the interest line, the un-hedged loans, they actually have no effect on cash because they're inter-company. So when you exclude that, I would say, our run-rate interest number is somewhere in the sort of low 20s to mid 20s right now. And what we have is when you think about our capital structure right now, our cash which is earning deposit interest is somewhat close to our variable debt, which right now is mostly commercial paper, the rest of our debt is fixed, it's bonds. So what I would anticipate right now is, you wouldn't see much of a material change in that until the next bond issuance. And at that point obviously when you do that new bond issuance, you will have a yield in what the prevailing markets are. And then that will be layered in. And you essentially will then have certain maturing bonds that might be at lower interest rates.

So from my perspective, what you're seeing today is mostly volatility of FX rates. And then as we go to the bond market in the future, at least based on the prevailing rates, I would expect to see net interest start to rise.

Speaker A-Jeff Zekauskas

Great. Thanks so much.

Speaker O-Operator

We will now take our next question from David Begleiter from Deutsche Bank. Please go ahead.

Speaker A-David Begleiter

Thank you. Back to Slide 4, Sanjiv, how should we think about returns on these projects and how is the competition shaping up for these projects? Is it more or less intense on your traditional projects. And first question, (inaudible) returns actually above your normalized rate given the uniqueness of these projects?

Speaker C-Sanjiv Lamba

David as far as we are concerned these projects have to meet the same investment criteria that we set out. So when we say that we want -- we expect returns to be commensurate with risk, there is no free pass for clean energy projects, they have to provide the same return profile that we see vis-a-vis the risk that we're taking on-board. So you can rest assure that our return profiles will reflect that on an ongoing basis as well.

As far as competition is concerned, I think competition is a little bit varied in this space as you'll appreciate, we have a range of players who all have a role to play. We are seeing partnerships shape up as maybe a critical part of the offering that comes to market as far as de-carbonization is concerned. And we believe strongly that I think good partnerships make a lot of sense for us as well both in managing our risk profiles, sub-surface is a good example of that. But also alongside that ensuring that we've got people with skin in the game particularly sometimes bringing an offtaker in as a partner to make sure they've got skin in the game and that offtake piece really has some teeth as we move forward.

So, a range of -- there's no -- it's an evolving market space, and we'll watch it to see how that competition piece evolves. But at the moment, that's kind of what we're seeing.

Speaker A-David Begleiter

Very good. And just on Europe, on your take-or-pay contracts, are you seeing any issues with any contracts given the current elevated energy price environment?

Speaker C-Sanjiv Lamba

Simple answer to that is, no. We have strong take-or-pay contracts. There are some customers who are below take or pay at the moment in Europe. But those contracts are being enforced and payments are happening.

Speaker A-David Begleiter

Great. Thank you very much.

Speaker O-Operator

We will now take our next question from Vincent Andrews from Morgan Stanley. Please go ahead.

Speaker A-Vincent Andrews

Thank you and good morning everyone. Matt, just wanted to circle back on the balance sheet question and get a mark-to-market from you on where you think Linde can borrow at these days? And then how that feeds into as you are discussing new projects. How are you baking in higher financing costs in terms of project returns and the like?

Speaker C-Matt White

Sure, Vince. I think with the projects, to me, we don't take the current prevailing rates and bake it in, in that perspective. And the reason is, as you know we're making 15, 20-year investments, and embedded with that we already incorporate inflation recovery on the facility fees. So when you tend to see elevated rates, that does come back through the inflation adjustment mechanisms as it is anyways. And we don't need to debt finance these projects as we build them, as you know they take several years to build anyways. So from that perspective we've been through many, many decades as you well know on interest rate cycles. And our long-term model continues to be quite resilient with the contractual inflation recovery that enables to equilibrate that.

As far as borrowing rates, yes, we're a single-A, but lately we've been tended to be more double-A or better on the spreads. When we decide to go to the market, I would expect our spreads should be, some of the better ones you would see, but of course it's from a benchmark that's higher today. So you can take the benchmark today and just take some of the spreads you've seen demonstrated at kind of our rating or better. And that sort of what we would borrow at. But at this point, I feel pretty good about our access to capital and still get some of the lowest cost capital around.

Speaker A-Vincent Andrews

Okay, great to hear. Thanks so much.

Speaker O-Operator

We will now take our next question from Laurence Alexander from Jefferies. Please go ahead.

Speaker A-Daniel Rizzo

Hi, this is Dan Rizzo on for Laurence. Thank you for taking my question. You talked a bit about the return on capital for investments. I was just wondering with the new opportunities in gray, green and blue hydrogen, if at this point if we should assume the return on capital is below due to the traditional products, but should exceed it within, I don't know, the next 5 years to 10 years or how we should think about return on capital on these new opportunities?

Speaker C-Sanjiv Lamba

So in terms of return on capital, let me go back to the question that I responded to earlier by saying that the investment criteria that we set out for our projects, double-digit un-levered returns is what we would look at, obviously commensurate with the risk that we take on. That is what is reflected in the projects that we currently look at and approve. And that is reflected therefore in the return on capital that you see within our business today. I expect these projects to continue to support that return on capital elements, and our investor --our investment criteria has not changed for projects in the clean energy space whether it's blue or green. Obviously there is some support available through the IRA that holds that return or supports that return profile as well. And of course, accelerates decision-making from our customers' point of view.

Speaker C-Matt White

And maybe I could just add one more point, Dan. When we make our decisions, we make it on an essentially a cash basis, an IRR un-levered after tax cash basis. So that won't change. As you know the ROC is more of an accounting metric. So, I wouldn't look at that 21.8% in a benchmark in any way or in any form. Obviously we're getting benefits there from the non-capital portion of our business today, which we expect to continue going forward. But when we make project decisions, as Sanjiv mentioned, it's more on an IRR basis when -- how we think about that.

Speaker A-Daniel Rizzo

All right. Thank you very much.

Speaker O-Operator

We will now take our next question from Geoff Haire from UBS. Your line is open. Please go ahead.

Speaker A-Geoff Haire

Good morning. Thank you for the opportunity to ask the question. I'm going to fly the flag for Europe slightly. With a lot of talk about the Inflation Reduction Act in the US, how has that influenced both politicians thinking in Europe from what you understand in terms of changing the way investments are done for low-carbon hydrogen in Europe?

Speaker C-Sanjiv Lamba

That's a great question, Geoff. It's topical as well because I had -- over the last couple of days I've had a number of conversations with political leadership in different parts of Europe. Two things, first, the IRA, I think came as a surprise to many people including many of the political leadership in Europe. And they have recognized that it has a galvanizing effect in terms of moving the pace at which change happens on clean energy in the US. And obviously are envious of that change given that European Commission requires time and a fair amount of work to kind of be able to get to its point of decision making.

The other piece I think is, that awareness has then led them to recognize that some urgent actions are needed. I'll give you two quick examples of conversations. I may not quote them in detail, but I'll let you know that the fact that Europe was all about green hydrogen only clearly has changed. And there is a greater acceptance of the fact that blue provides a very effective bridge to getting to clean energy in due course. Today Europe just need energy, they are burning more coal than they had planned for as you know.

So really that pragmatism, which was lacking in the past on making sure that low-carbon intensity hydrogen was welcomed into Europe, on par there was no discrimination against blue versus green et cetera. I think that's some -- that's a change that I think is fundamental and we will see some of that. And the fact that Europe has also recognized that while they can talk about developing projects in Europe, they desperately need to ensure that they have processes in place to import significant amounts of clean energy, and in this case blue, green, hydrogen, ammonia et cetera into Europe to be able to leverage and build infrastructure needed is the other change that I'm expecting to see in the near-term.

So I'd say the IRA has provided some real soul-searching opportunity for Europe. And they are going to do something about it.

Speaker A-Geoff Haire

Thank you.

Speaker O-Operator

We will now take our next question from John Roberts. Your line is open. Please go ahead.

Speaker A-John Roberts

Thank you. If you add sequestration to hydrogen for an existing refinery customer, do you expect that existing refinery customer to pay a premium for blue hydrogen or you just expect to get the credits to cover the cost of adding sequestration and how did the existing contracts anticipate this? I'm just trying to understand from the customer's perspective how this is going to work.

Speaker C-Sanjiv Lamba

John, when we look at customers and discussions that we're having, the customers are themselves trying to leverage that blue hydrogen into their own product slate, in some cases moving towards more renewable fuels, which then attract significant and attractive further benefit that come out of places like California as an example. So moving to renewable fuels, accessing California's low-carbon standard framework and accessing further incentives allows them to consider premiums that would become available on the -- and pay for on the blue hydrogen as well.

But in truth, I'd say to you that if I look at broad-based adoption of blue hydrogen, the IRA provides through the 45Q credit a significant benefit in terms of accelerating that decision and does come -- from a point of return perspective does support the return to moving to blue hydrogen even with marginal premiums on it.

Speaker A-John Roberts

Thank you.

Speaker O-Operator

We will now take our next question from Kevin McCarthy from Vertical Research Partners. Your line is open. Please go ahead.

Speaker A-Cory Murphy

Good morning. This is Cory Murphy on for Kevin. In your packaged gases business, can you comment on what you're seeing in terms of demand for hardgoods as opposed to gas and rent. I recall the hardgoods tend to be a leading indicator. So curious if you're seeing any trends in the business that would pretend slower macro growth ahead? Thank you.

Speaker C-Sanjiv Lamba

Thanks. So hardgoods business both on the package side, I'd say to you, both gases and hardgoods business are both growing double-digit as things stand. On the hardgoods side, we look at two different aspects of it, when you talk about kind of leading indicators to what we're seeing around economic activity, we see both on equipment sales as well as consumable sales. And I can tell you, I see demand and growth on the equipment side as well, which suggests that people are still putting some cash on the ground to make sure that they are able to catch up with many of these supply-chain issues that have plagued manufacturing more broadly. So I still -- at this point in time still feel pretty good about where we are seeing hardgoods development as things stand. And I'm talking about the US here.

Speaker A-Cory Murphy

Got it. Thank you.

Speaker O-Operator

We will now take our next question from Mike Sison from Wells Fargo. Please go ahead.

Speaker A-Mike Sison

Hey guys, nice quarter. Just curious and sort of impressed that your volumes remain positive given recessionary conditions or no growth. If demand firmly goes negative in '23, what do you think your volume outlook would sort of unfold in that scenario?

Speaker C-Sanjiv Lamba

Hey, Mike, I'd love to speculate, but I'm not going to do that. We'll come back to you in the next quarter, you know, and we'll give you a full outlook for 2023. We're going to go through our own very detailed planning exercise. I'll have the guys in here from all over the world over a three day period where we will run-through each one of their planning processes, a lot of these assumptions will get tested and challenged in the course of that. But again, I just want to -- I think the point that you make is that resilience stands out Mike. And sometimes people take that for granted, but in our case, we recognize and our volumes showing through is just another element of that resilience in addition to the fact that, I explained at the last earnings call our defensive business model including the contractual structure that we have even when volumes are down, we're able to actually preserve much of our profit and our top line as well. Again just a recognition of that is quite important in these times particularly. But we'll give you more in the next quarter for sure.

Speaker A-Mike Sison

Okay. Thank you.

Speaker O-Operator

We will now take our final question from Mike Harrison from Seaport Research Partners. Please go ahead.

Speaker A-Mike Harrison

Hi, good morning. I have two questions. First of all in Europe any thoughts on the recent decline in natural gas prices and what that could mean for your costs. Are you going to realize some of that? And then the second question is around electronics, you acknowledged that there has been some negative headlines around semiconductor producers. Curious for some additional color on the near-term and longer-term impacts that might have on your electronics business if there is some reduction in capital spending from those steps. Thank you.

Speaker C-Sanjiv Lamba

Thanks Mike. So, just on natural gas very quickly on EMEA, obviously we've seen continued volatility around natural gas pricing. We've been able to push that through our contractual cost pass-through structure. We will continue to do the same. If natural gas prices come down significantly, margins will get enhanced. As a consequence as you know it's a clear math around how pass through works. And really no concerns from our perspective. Obviously lower natural gas pricing will help the broader economy, and hopefully some economic tailwind as a result of that which should be positive for us.

As far as electronic segment is concerned, let me kind of break that up into two-parts, let's start with the long-term, in terms of investments being made and the CHIPS Act out of the US and a similar act out of Europe pushing to have localized investments in their regions continues to drive fab investment as we move forward. In conversations with some of our largest customers more recently, I have seen commitments from them of staying at the same level if not increasing their investment levels. Some of them tend to invest counter-cyclical, that's been a strategy that's worked well for them. And I expect to see those levels remain fairly stable in the midterm, I'd say. So that's -- from now till the next 4 years to 5 years. Of course we are winning more than our fair share of those, and I feel good about the fact that we'll see continued growth as a result of that.

In the near-term, most of our large customers continue to consume, which is what I pointed comment I made earlier on that despite what you read in the press, our consumers continue to consume gases at every fab that we supply. And that's a really good position to be in. There are some concerns around China that I've heard from investors as well. And again I wanted to confirm that our volumes in China continue to be un-impacted by current embargoes and so on and so forth that might exist. They might have an effect on longer-term investments in China. But we are yet to kind of see that reflected in the demand pull that we see from the markets.

Speaker O-Operator

I would now like to turn the call back to Juan Pelaez for any additional or closing remarks.

Speaker C-Juan Pelaez

Cecelia, thank you. And thank you everyone on the line for participating in today's call. Please feel free to reach out if you have any further questions. Have a great rest of your day. Take care.

Speaker O-Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.