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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Second Quarter 2021 Linde's Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference may be recorded. [Operator Instructions]

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

Juan Pelaez

Vice President-Investor Relations, Linde Plc

Crystal, thank you. Good morning, everyone and thanks for attending our 2021 second quarter earnings call and webcast. I am Juan Pelaez, Head of Investor Relations, and I'm joined this morning by Matt White, Chief Financial Officer; and Sanjiv Lamba, Chief Operating Officer.

Today's presentation materials are available on our website at linde.com in the investors' section. Please read the forward-looking statement disclosure 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 of this presentation.

Sanjiv and Matt will now give an update on Linde's business outlook and second quarter performance and then we'll be available to answer questions.

Let me turn the call over to Sanjiv.

Sanjiv Lamba

Executive Vice President & Chief Operating Officer, Linde Plc

Thanks, Juan, and good morning, everyone. Linde employees, once again, produced stellar results in the second quarter, achieving multiple new records including a 24.2% operating margin, a $2.70 earnings per share, and 15.7% return on capital. Volumes grew 15%. Pricing increased 3% along with global weighted inflation and we continued to optimize the business through many productivity initiatives.

I'm really proud of how the Linde team delivered industry-leading performance, despite the many challenges we constantly face. And I expect to continue this performance for many years to come.

Last quarter, I presented to you the Linde's strategy, which outlined the levers that we use to grow EPS, more than 10% per year. Given the results so far, I think it's safe to say we are well on our track. That said, I believe it's also important to have a clear path to future revenue expansion, which I'd like to discuss on the next slide.

So, on slide 3, you'll see that when previously I had highlighted to you that Linde has a unique advantage of being able to offer its customers a sale of gas or sale of plant option. Our engineering capabilities are a clear competitive advantage, allowing us to participate in almost every type of growth opportunity, while maintaining our investment criteria. Going forward, we are, therefore, going to present the sale of gas and sale of plant backlog combined.

This quarter, our total project backlog stands at approximately $7.5 billion, representing contractual growth with high-quality customers and secured cash flows. Now, in addition to this project backlog, in parallel, we also invest around $1 billion per year on base business growth opportunities. These are great opportunities to deliver high-quality long-term growth, but they are either under $5 million in spend or don't contain contractual fixed fee elements for secured incremental growth.

Base growth projects typically also have shorter execution times, are margin accretive and support our network density strategy. Some examples include the clean energy projects we announced earlier this year, the hydrogen liquefier in the US Gulf Coast that we recently started up, and of course, more than 25 small onsite projects that we have already won this year. We serve glass, pulp and paper, mining and other growing end markets with these small onsites.

In addition, the business continues to leverage our dense network with winning new merchant and packaged accounts, which further enhances the quality of our business. As stated, we currently have approximately $7.5 billion of contractually secured growth projects, which we'll execute over the next three to four years, plus $1 billion per year of incremental base growth CapEx. The revenue expansion from these investments, exclude organic growth already being captured from our existing dense supply network across a diverse spectrum of end markets, of course, we well demonstrated how we leverage this through the current economic recovery that you're seeing.

As I sit here today, we are currently reviewing a pipeline of hundreds of prospective projects, not included in this backlog, which easily represent more than $10 billion of potential investment opportunities, including a significant number of electronics and clean energy projects, and of course sale of plant projects.

Both sale of gas and sale of plants are great ways for us to grow, while maintaining our investment discipline. Given our strong execution capability, I remain bullish on Linde's outlook and growth prospects. Regardless of what happens with inflation or macroeconomic trends or the pace of secular growth drivers, we have a proven business model that can generate compound value growth for our shareholders today and decades into the future.

Now, before I hand over to Matt, I want to make a comment on our ESG goals. I mentioned to you in last quarter's call that we are developing new ambitious ESG goals, which we expected to share in the near future.

We've been diligently working with our business leaders around the world to determine these targets and more importantly, to incorporate them in our operating rhythm. Based on that progress, I expect to disclose these new ESG goals before the end of the year.

I'll hand over now to Matt who will take you through the financial results and guidance. Matt?

Matthew J. White

Executive Vice President & Chief Financial Officer, Linde Plc

Thank you, Sanjiv. Please turn to slide 4 for an overview of the second quarter results. Sales of $7.6 billion are up 19% from 2020 and 5% sequentially. Versus prior year, volumes increased 15% across all supply modes and end markets.

Manufacturing, chemicals and metals drove this increase since Q2 2020 was the low point for cyclical markets. Sequentially, volumes increased 4%, which marks the fourth consecutive quarter of volume expansion, demonstrating our leverage to the economic recovery.

Price increased 3% versus prior year and 1% sequentially as all geographic segments continue to manage inflation. This is also evident in the 2% energy cost pass-through related to onsite contracts.

Operating profit of $1.8 billion increased 39% over prior year and 9% sequentially. Operating margin of 24.2% was 350 basis points over last year, despite a 50-basis-point headwind from cost pass-through. This represents the eighth quarter in a row we have increased operating margin more than 200 basis points from a combination of volume expansion, pricing actions, and productivity measures. EPS of $2.70 increased 42% from 2020 and 8% from the first quarter. We've also provided the Q2 2019 growth rate of 48%.

As mentioned last quarter, I believe it's important to distinguish true growth, which this clearly demonstrates from mere recovery. ROC, which is one of the most important metrics in this industry, rose to a record 15.7%. It has increased every quarter since 2018 from steady profit growth over a prudently managed capital base. In fact, Linde has consistently proven the ability to deliver industry-leading high-quality growth by following a disciplined capital allocation model. Slide 5 provides more color on that capital allocation model, including overall cash management.

You can see the progression of operating cash flow on the table to the left, with the first half up 27% over last year. Note that we had $300 million of higher cash taxes this quarter when compared to Q2 last year. Since this is only timing related, I expect operating cash flow to improve year-over-year and sequentially in the third quarter.

To the right, you can see how we allocated capital for the first half of this year. Stated simply, we want to grow the business, invest back into the business and reward our shareholders with increasing dividends and share repurchases. I think the pie chart below confirms this approach. We invested $1.5 billion into the business and returned $3.2 billion back to shareholders.

I'll wrap up with guidance which you can find on slide 6. This slide is similar to last quarter, including how we set the guidance ranges. Third quarter guidance is $2.60 to $2.70. This represents 21% to 26% growth over prior year and 34% to 39% growth over 2019. Compared to Q2, this assumes no sequential improvement in the underlying economy and 1% foreign currency headwind.

For full-year 2021, we are raising prior guidance by $0.50 to a new range of $10.10 to $10.30. This $0.50 increase is from the Q2 outperformance and the higher Q3 guidance range. In other words and consistent with last quarter, we have not updated the fourth quarter at this time. Rest assured, next call, we'll provide an updated and more meaningful fourth quarter guidance.

And if volume trends are stable or improve, we'll be at the upper end or above this range. Until that time, we remain highly confident in our ability to grow 2021 EPS at least 23% from last year and 38% from 2019, while positioning Linde for industry leading long-term value creation.

I'd now like to hand the call over to Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from David Begleiter from Deutsche Bank. Your line is open.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Sanjiv and Matt, these 15% of volume growth in the quarter, what do you think that was versus the industry? Did you gain share do you think this quarter versus competitors?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

David, thanks for the question. So, as you saw solid growth and we mentioned across all end markets as well, the reality is we saw that economic recovery come through. We've said as part of our strategy, we'd leverage that economic recovery. That's what we're seeing happen around. I would say that in some markets we have seen some share gain. But that's kind of an ongoing business transactional element that we see all along.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Very good. And, Matt, thinking about share buybacks, how should we think about buybacks in the back half of the year?

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

Yeah. So, David, as you know from our capital allocation policy, we'll continue to sweep excess cash towards buybacks. So year-to-date, we've been over $2 billion. We're on a good pace.

And as I mentioned, I expect Q3 cash to be higher. So, I see no reason why we need to deviate from kind of our current pattern. But, obviously, our priority continues to be to invest in growth, which we're going to do. And as Sanjiv mentioned, we have a lot of opportunities there. But we'll also be repurchasing shares pretty much every day in the market.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Thank you. Our next question comes from Tony Jones from Redburn. Your line is open.

Tony Jones
Analyst, Redburn (Europe) Ltd.

Q

Oh, thank you. Thanks for letting me ask questions. Good morning. Yeah. I've got two, actually, one was on volumes. So, if I look at, say, Q2 2019 and then sort of adjust for the price and cost pass-through this quarter as just reported, that sort of implies volumes are up about 3%, 4% versus that Q2 in 2019, but slightly down in Asia.

Firstly, I guess is that right? Does it maybe imply some further optionality in Asia Pacific? And can we use that sort of underlying 3% to 4% volume growth versus 2019 for the next couple of quarters?

And then a second question – sorry, if I'm asking quite a few things here. CapEx in the cash flow and also as a percentage of sales, looks like it's been trending down for a while, but the project backlog looks really solid. How should we think about that? Or is it just the post-pandemic timing effect of investments? Thank you.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Tony, thanks. Why don't I jump into the CapEx piece and then I'll ask Matt to just talk through the volumes and reconcile them.

Just on CapEx, I think one of the reasons we're providing that pipeline view today was to give you a sense of how we see that opportunity. I've said in the past, I've seen some improvements in proposal activity across both sale of gas and sale of plants. And on the sale of gas side, that proposal activity particularly coming from electronics as an example and, of course, a suite of clean energy projects and the most traditional markets as well, including chemicals and others.

So, I do expect to see that CapEx reflecting the pipeline opportunity that we just defined. So, I don't see – I mean, the changes are marginal anyway. But not withstanding that, I see absolutely no concerns around how I expect that pipeline to flow into backlog. Matt?

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

Yeah. Thanks. And, Tony, yeah, just to answer the volume question. Your calculation is close, but it's about 5% globally is what we would have seen Q2 volumes versus 2019 from this quarter.

And Asia-Pac actually is leading, it's more around 8%. So, I'm not sure if maybe on the deconsolidation or how you calculated that. But the volumes in APAC were about 8% above Q2 2021 versus Q2 2019. And we're pretty much up mid-single digits across the board for all the regions. So, I would say we're seeing the right patterns and the right traction and, obviously, price 3% to 4% as well when you look at that metric versus 2019.

Tony Jones
Analyst, Redburn (Europe) Ltd.

Q

Thank you. That's great. Good detail.

Operator: Thank you. Our next question comes from Bob Koort from Goldman Sachs. Your line is open.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Thank you very much. Good morning.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Good morning.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Guys, I wanted to ask about the Jurong Island project that was going to start up in 2023. How's that progressing? I think it's your biggest ever investment and what have you learned if anything about building those gasifiers? Thanks.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Thanks, Bob. So, you know, one of our larger investments as you rightly pointed out, you know, that's progressing well. Obviously, there has been some COVID impact on our schedule as well as of our customers. That's still on track to getting largely mechanically complete by the dates that we'd originally set out plus or minus a few weeks.

And to be honest, Bob, we've been running gasifiers at that Singapore site for decades. So, really none of this is new for us from an engineering point of view. We've been building gasifiers for four decades as well. So, there's a lot of that – organizational learning that we've been able to put into that project. So, it's coming along quite nicely.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

And as a follow-up, if I might, you guys have an interesting seat in the whole gas or hydrogen economy that's developing. Wondering if you can give us your latest thoughts on which way that's going. Is it going to be globally distributed hydrogen from single complexes in the best electricity areas? Is it going to be locally-produced hydrogen? Is it going to be ammonia? Any updated thoughts on how you see that ecosystem evolving?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Sure, sure. Happy to provide that, Bob, and that's a great question. So, it is – as you rightly pointed out a very fast developing dynamic space. And we start to talk more and more about clean energy more broadly. But just talking about the specifics of what you've asked. So, our view is when we think about our strategy, we believe, you know, local execution and locally driven strategies are where we see the most value creation in terms of our business model and in terms of how we kind of attempt to take that strategy to execution. We are demonstrating that with South Korea in a local market where we are putting our liquefier and building a whole ecosystem around liquid fueling for heavy-duty vehicles. So, that's kind of broadly our strategy.

Now, I must add to that, that with all of that obviously we also recognize there's a portfolio approach that we would be taking to this. And we do expect to see that there will be some larger installations that would feed markets, which may not be entirely local, which might have some export content to it. But we do see the distributed model as being certainly both more effective and creating greater value, but supplemented in cases by some larger production facilities. But you have some obvious competitive advantages.

I mean we've talked previously about how you could get in Northern Africa, as an example, very low cost electricity that allows you to put a large complex green hydrogen production facility. And the best way to get that hydrogen to market, as an example, would be to then take it from that large complex and pipe it across to Europe if you could.

And again, you'd have to repurpose some of the existing pipelines and make sure that cost effectively gets to Europe for it to have some traction there. So, that's one example where we think you would see changes like that happened. In Chile, with the desert has a similar advantage of very high quality and solar ability to take that, put into renewable power, generate green hydrogen, and then move it to markets close to it. Does that give the color you were looking for, Bob?

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Perfect. Thanks so much.

Operator: Thank you. Our next question comes from Nicola Tang from Exane BNP Paribas. Your line is open.

Nicola Tang
Analyst, Exane SA (United Kingdom)

Q

Hi, everyone. And thanks so much for the interesting color around the project backlog. And I want to talk a little bit around that. Whilst the backlog itself is pretty solid at the $7.5 billion, the size of the backlog itself hasn't really been growing. If anything, I think it was more like $9 billion or $10 billion a couple of years ago.

If you talked about those hundreds of projects worth potentially $10 billion, can you talk about the potential timing of adding those into the backlog? As existing projects come online and then, therefore, drop out the backlog, do you expect to see growth in the backlog or actually it will be more stable at current levels on a sort of net-net basis?

And then the second question similarly around the backlog – I was just curious, Sanjiv, you mentioned that I mean, you're seeing project activity or potential project activity in traditional sort of industrial areas. I was curious to understand what areas you're seeing that pickup in activity. Yeah – and then I've got a next to it, but I'll put it back.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Thanks, Nicola. So, let me start over the backlog and then we'll come back to the project activity pickup that I referenced. So, as you said, the backlog is $7.5 billion. It gets impacted by startups that we have. So, we are going to have some startups later this year and we'll see that impact flow through. You've actually got some press releases that we had recently around some of those as well.

Now, in terms of timing of the projects coming into the backlog, as you know, we don't often control that timing. More often than not Juan controls the timing, because he kind of doesn't let us announce many of these wins. But notwithstanding that, you will see in the second half an improvement in that backlog come through because we're very close on a couple of projects, which we think will be formally closed out, which is contract signed before we can bring them on. Again, Nicola, you know this, but I'll just recap it.

Our conditions of putting something in the backlog are very stringent. They have to be secured by a contract. It must be more than $5 million. Obviously, for the larger projects that doesn't matter. And it needs to have a guaranteed cash flow profile, which ensures that, that backlog then has incremental – guaranteed incremental growth.

So, those conditions have to be met and we see a number of projects that will flow into the backlog later this year. And then, some obviously in the early part of next year as well. So, I feel reasonably confident on the developments that we're going to see in that backlog, both on the sale of gas and the sale of plant side.

Now, I'll move on to the proposal activities. So, I'm going to talk about one area in particular, where we see a significant amount of activity and you've heard me referenced this before Nicola, so it won't come as a surprise, which is electronics.

And, you know, really you've been hearing in the press obviously a lot about chip shortages, but the reality is that, that industry has been looking at ramping up its production capabilities for about 12 months now. And there are a host of projects that are all in various stages of development by TSMC, by Samsung, by Intel, by GlobalFoundries, there's a long list of people who are going to be investing in that space. And, therefore, a large part of our time at the moment in that proposal activity is being spent around the electronics area in particular, Nicola. Now, in addition to that, we're also seeing some chemicals projects, we're also seeing even – and it might surprise some, but even in the steel area, we're seeing some projects.

The one other area, Nicola, which kind of is really linked to clean energy, but where we're seeing refining, chemical, even steel companies engage actively with us is around reduction in their emissions or in the case of refining, what can we do around carbon capture and making – reducing their emissions, how can we help them create technical solutions.

I've said this before in the last call that we have a full suite of technologies around us. We have the ability working with partners to provide a holistic solution to many of our customers in that space. And, again, we're seeing a lot of activity pickup on that and move forward.

Nicola Tang

Analyst, Exane SA (United Kingdom)

Q

That links nicely to my last question on sort of the de-carbonization point. I was wondering if you had any initial thoughts on the EU's Fit for 55 proposal and potentially what it means for Linde or the wider gases industry, I suppose, and whether there's any sort of progress on the CO2 framework on the US side and some, what could that mean to you.

Sanjiv Lamba

Executive Vice President & Chief Operating Officer, Linde Plc

A

So, Nicola, you heard me say this before that for de-carbonization more broadly and the hydrogen economy particularly the pickup, we need a couple or three things to happen. Obviously, regulation with teeth, we've seen that happened very much in Europe. I think your point is absolutely valid that we see Europe provide the kind of penalties and incentives, the carrot and sticks, which are allowing momentum to build in that space quite actively and aggressively.

So, that's good to see and we are participating in that, whether IPCEI funding, whether it's other incentives, whether it's the – a broader coalition that is looking at contract for differences to make sure that we are leveraging facilities elsewhere to support European economies.

I've also said, and of course, just to make the point, in the US, we are encouraged to see progress happened in that area as well. Now you know that the US currently offers a 45Q. Our view is that that is inadequate for any substantial momentum to build up in the space. But I'm encouraged by – conversation is going on in the House and hopefully in the Senate that will move some of the incentives and proposals forward in that space. So, I'm looking forward to seeing developments there quite closely.

So, I guess, the other couple of things that need to happen, which I think, you know, create the momentum that we need. And I am, you know, at the risk of repeating myself from the last call, you know, we do need to see that

– the technology roadmaps ensure that the technology for either green and blue, which is currently available and scalable, you know, creates the cost curve that is necessary for large scale adoption to happen.

That remains, you know – I won't say that the challenge that is actively being worked on, but there is a timing challenge to that and it'll take years before we get to a point where green in particular has the ability to have a cost effective solution available at scale. Good solutions are available today. We provide many of those ourselves, but I recognize that there is still a scale up, that is currently lacking in the green hydrogen space.

And finally, I think we need to be working very closely with making sure that the endpoint consumption, so in this case, if we are talking about heavy-duty vehicles, buses or trucks or indeed trains and ferries that technology development in that space is happening actively. Hence, the number of partnerships that we do to make sure that we're right in the middle of those developments and we are encouraging and promoting them as much as possible.

So, I know, I've provided a more broader answer than you were looking for, but I think this was worth recapping because these are the things that are ensuring that the momentum that we see today sustains and you actually see investment in development in that space.

Nicola Tang
Analyst, Exane SA (United Kingdom)

Q

That's great. Thank you so much.

Operator: Thank you. Our next question comes from Jeff Zekauskas from JPMorgan. Your line is open.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Your returns on capital have moved up, which is natural given your cost reduction programs and growing economy. Have your returns on capital though in your onsite projects really changed over the past couple of years? That is – are the returns on capital in onsite going up or staying the same?

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

Jeff, this is Matt. How are you?

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Hi.

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

So, our investment criteria is the same, so we've maintained that throughout. And, therefore, how we look at the projects and the expectations we have remain the same. But to your exact point, given the density model that we have, we're getting significant growth on this business on a non capital-intensive basis. And then we continue to deliver on our projects, start up our projects, and execute those projects, which deliver on the expected returns that we entered into them on. And the combination of the two is giving us a significant acceleration in return on capital. And at this point, we continue to see this happen. And as long as these trends continue, it should bode well for that metric going forward.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you for that. And in your – in the hydrogen area, when you contemplate various projects, are any of the projects that you contemplate involved with ammonia being made in some jurisdiction, whether it's the Mid-East or Australia or somewhere else? That is – are you working with any possible builders of those projects or you're not doing that?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Right, Jeff. So, I'll headline that by saying, yes, we are – and I want to kind of give you a slightly broader picture as well, Jeff, just to give you a sense of where we stand on the hydrogen piece.

So, as you know, I've mentioned this before on a previous call that we run our Linde Hydrogen Council. We meet every month. We review all the projects. The last review we had a couple of weeks ago was – saw 240 projects across that whole range of opportunities in that space, adding up to what we call probability-weighted CapEx value of about $4.1 billion. So, again, these are – some of these are larger projects, obviously large – we see a large number of mobility projects, which tend to be somewhat smaller.

But to your point, one of the areas where we're seeing both the increase in the number of projects as well as large size projects is the space of carbon capture. And beyond that, we then look at hydrogen and ammonia as being two elements, which kind of get added on downstream to that.

So, the answer is, yes, we're working with a number of different customers and players who are looking at the ammonia loop. Jeff, you may also be aware that Linde has its own ammonia loop technology out of Linde Engineering. So, we've done a number of these ammonia loops elsewhere, including in the Middle East and in Eastern Europe and in the US. So, we have that unique advantage of being able to tie both or all of those technologies in and provide those solutions, which makes it very attractive to many of our customers.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much.

Operator: Thank you. Our next question comes from P.J. Juvekar from Citi. Your line is open.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Yes. Good morning, Sanjiv and Matt. Sanjiv, does your deal with ITM give you any advantage in winning green hydrogen projects, since you have the PEM technology through the joint venture and can you sort of give any examples of that?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Yes. P.J., hi. So, yes, of course. So, the deal with ITM is unique in many ways, P.J. The first that we are an equity investor in ITM that means we are still in the game with them. But more importantly, we have a joint venture with ITM that there is a Linde Engineering ITM joint venture called ILE, which is where all the scale up on larger projects above a particular size happens. And that is what gives us the unique competitive advantage of having access to great PEM technology and being able to support ITM in scaling that up for large projects that we are – that we're looking at and pursuing.

And again, you know, we are seeing good developments in that space. A lot of proposal activity, P.J., as I referenced earlier on. We are very close in a number of cases in those discussions with some select customers. So, really pleased to see that ITM linkage and find ourselves leveraging that quite actively, as we develop these projects.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Great. Great. And sticking to green hydrogen, you also had a deal with Plug Power to use their fuel cells to convert some of your Class 6 and Class 8 trucks over to hydrogen. Can you give us an update on that? Thank you.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

So, P.J., we're working with Plug Power and we've worked with Plug Power in many different ways, we supply most of their hydrogen requirements today as an example, you know, while they don't have their own facilities up. We are also looking at collaborative development in a number of other spaces, which hasn't been announced yet. But we are kind of progressing on different fronts over there.

One of the things that we have agreed with Plug Power and I must admit here with a few other players as well is that we will be trialing on our trucks the fuel cells and then we'll be moving our trucks to hydrogen. So, we already have a plan in place for the US, for Europe, and South Korea to be progressing with those trials and seeing how they move forward. So, again, lot of activity happening in that space. We are really waiting with bated breath P.J. to get these trucks on the road.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Great. Thank you.

Operator: Thank you. Our next question comes from Peter Clark from SocGén. Your line is open.

Peter Clark
Analyst, Société Générale SA (UK)

Q

Yes. Good morning, everyone. Thank you. The first question is around – is actually following on from the first question you had about the market share. Particularly looking at the US packaged gas business, because I know there's differences in mix, I know the biggest competitor out there has a lot of hard goods, a lot of construction. But you've been seeing double-digit growth now in that business in the first quarter. You probably accelerated in what you saw in the first quarter, in the second quarter. And they're still actually down particularly dragged backed by the hard goods. So, I'm just wondering are you taking some share? Or is it all about mix maybe regional?

And then the second question is around the investments. Obviously, you're very excited with all the organic investments you have and the potential for that. I'm just wondering on the potential acquisition line. Are you just not seeing many potential targets that fit the criteria on return, given what you can do internally with your money? Thank you.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Thanks, Peter. Great question. So, I have to admit, Peter, I am thrilled with the US packaged gas business and the way that team is really moving forward at the moment with that, we see double-digit growth both on gas and hard goods. We see strong sequential growth on both of those elements as well. So, I know I've read some of our competitors talking about that space, but the reality is, we are certainly growing very strongly in that space, and I see us kind of moving forward.

Anecdotally, obviously, people will tell you that we're taking share, but I don't particularly want to comment on that. That is anecdotal. But you can look at the numbers and I think the comparison will kind of tell us on – get you to the right conclusion. So, again, very strong performance over there on both hard goods and gases.

If I move on to investments and talk a little bit about the acquisitions piece. So, one of the challenges, Peter, as you'll appreciate given where we stand and our size and having some – lived through three years of regulatory approvals on the merger, we are very sensitized to how large acquisitions can happen. So, we are left with a much smaller pool of opportunities there. We will do tuck-in acquisitions in most of our markets any day, a good high-quality tuck-in acquisition, we will go after, and we will do that as soon as we find them. And, of course, they have to live up to our investment criteria requirements, as you know well.

The larger ones become a little more challenging, particularly as we've got to kind of understand the requirements from local regulatory environments or antitrust etcetera, and that's where typically something larger trips up.

So, do I expect to see us doing acquisitions moving forward? Yes. Will you see a large number of tuck-ins happen? Most likely where we find those opportunities come through, we will certainly pursue them all day long, if we could.

Peter Clark
Analyst, Société Générale SA (UK)

Q

Got it. Thank you.

Operator: Thank you. Our next question comes from Geoff Haire from UBS. Your line is open.

Geoff Haire
Analyst, UBS AG (London Branch)

Q

Good morning. Just had two very quick questions. First of all, in the margin improvement that you report, can I just check, does that include any benefit from rising energy costs? And if it does, could you possibly break that out?

And then just looking at the operating cash flow, which is obviously flattened Q2 year-on-year and down sequentially, you've mentioned higher cash taxes. Are there any other movements within the cash flow in the quarter that have a negative impact?

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

Okay. Hi, Geoff. It's Matt. I can answer that. So, I think your first question, just to make sure I got it right, you were asking about margin related to energy. Can you repeat that one again? I kind of lost it a little bit.

Geoff Haire
Analyst, UBS AG (London Branch)

Q

Yeah. So, obviously, you've got big margin improvement that you've been reporting almost every quarter since you've come – you've merged. What I'm just trying to understand is within that margin improvement, you've obviously had rising energy costs. Does that give you a benefit to the margin as well? And so, I'm trying to look at what the margin improvement would be net of rising energy costs.

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

Yeah. So, on that one, the actual – the rising energy costs will dilute your margins, and that's what we call cost pass-through. So, we isolate cost pass-through. And, obviously, what that is, it's a simple grossing up. So, you'll see the sales and cost of goods rise equal dollar amounts. So, therefore, it has no effect on our variable contribution or gross contribution dollars. But it will have a negative effect on your margin, because you're simply doing a gross up effect.

Geoff Haire
Analyst, UBS AG (London Branch)

Q

Yeah.

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

So, we isolate that out as cost pass-through. That is primarily natural gas and electricity energy. So, those components tend to drive that. Obviously, as inflation, you're seeing in those type commodities rises. We will pass them through, but they will dilute our margin.

So, for example, year-over-year, I'd mentioned while we're up to 350 bps on our margin, that includes a 50-basis-point headwind related to this cost pass-through. So, excluding that, we would have been up 400 basis points year-over-year. So, we are passing it through as our contracts enable, but it will be dilutive.

As far as operating cash flow, yeah, to your point, the $300 million that was incremental year-over-year, it's about $250 million sequentially with the impact of taxes and that is purely timing, just when payments were made.

In addition, working capital probably was about 100-or-so-million-dollars unfavorable. Part of that is growth. And we are growing, so we're consuming a bit of working capital. But when I look at our cash conversion cycles, our DSOs, they're quite good across the board.

Another piece is simply engineering timing. As you saw, engineering was consuming a bit of their backlog. What that is on a cash cycle, you tend to have more of a negative downside. But as Sanjiv mentioned, we have a high degree of confidence of our entire backlog, including sale of plants. So, we feel that something, looking forward, will turn around. And I feel pretty good about where our Q3 cash flow will be in making some of this timing backup both on working capital as well as cash taxes.

Geoff Haire
Analyst, UBS AG (London Branch)

Q

Thanks.

Operator: Thank you. Our next question comes from Markus Mayer from Baader Bank. Your line is open.

Markus Mayer
Analyst, Baader Bank AG

Q

Yeah. Good morning, gentlemen. Two questions from my side. First one on your nitrogen business. Given the recovery of the oil price, was there really a positive effect on your nitrogen for enhanced oil recovery business? And if not, what kind of oil prices do you think you need or your business need to see a recovery there to come back to 2013, 2014 levels.

And the second question would be on the effect of startups you expect this year and also next year that you can basically strip out the underlying business, because of this new business?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Thanks, Markus. So, your question on nitrogen enhanced recovery using nitrogen. As you know, we've got a couple of large customers that do that. That's been fairly stable through this period. So, we haven't really seen significant volatility in that. It's been stable and works right through. The geology is, Markus, that as you are using nitrogen for enhanced recovery, you are then in that process linked to that, you can't really step out or provide a lot of volatility, it isn't great for the field. So, you see that at fairly stable levels.

In terms of start-ups, yes, we do have a number of start-ups happening. As you know, from time to time, we kind of release – you know, provide a press release that covers some of those. I don't want to name them, but we do have a few happenings towards the end of this year. And yes, beginning of next year as well, there'll be a few more start-ups that will happen.

Markus Mayer
Analyst, Baader Bank AG

Q

But that kind of magnitude of growth, can you give us some kind of indication?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

So, one way to think about that, Markus is, I'll bring you back to something that we said in the past and just gives you a correlation, which is when I think about our EPS growth I'd say, you know, our backlog and therefore that really – that backlog getting converted into start-ups provides us roughly a two percentage point over a three to four-year period. That's what we're likely to see from the backlog that we currently have. And that's one way to think about how that start-up impact comes through down to the EPS level.

Markus Mayer
Analyst, Baader Bank AG

Q

Okay. Thank you.

Operator: Thank you. And our next question comes from John McNulty from BMO Capital Markets. Your line is open.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Good morning. Thanks for taking my questions. So, I guess, two of them tied to the same topic, which would be inflation. So, obviously, we're in a really kind of almost hyperinflationary market. Can you remind us in terms of the backlog that you've got and the projects that are in that backlog, how much of the equipments, the materials, etcetera, have already been locked up so that you don't have to worry about the inflation and what percent is maybe not necessarily locked in at this point that we have to kind of think about?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Sure. John, so when we get into a point of securing a project, whether it's on the sale of gas or the sale of plant side, by then we get into a very – a fairly detailed costing mechanism, and we lock in our cost at that stage with all the OEMs in particular, but other sub-vendors as well.

So, when we are in a backlog stage, most of our costs are already locked in pretty much. So, that should give you a sense of how we stand. As we're seeing inflationary trends now, we're already factoring those in into the proposals that we are developing and providing to customers.

So, again, we have good mechanisms in place, a lot of experience of having managers, John, to make sure that that coverage is very strong and a very diligent process or rigorous process around it in our engineering team.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. No, that's helpful. And then, I guess, just kind of tied into that, given this inflationary environment, it does look like your European business, your Asian business, we saw some price acceleration. Is that something, given the inflation levels that we're seeing, that we could see further acceleration from the pricing that you're putting through? I know it's pretty lofty already, but can we see even more of that just given the environment? How should we think about that?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

So, John, that's a great question. And as we've kind of shown, 3% overall pricing comes through – you know that a large part of the pricing comes through the merchant and packaged business. And very little of that really comes through the onsite line. So, therefore, you can do the math and you'll get to a number that says mid-single digit on average on pricing across those different segments particularly from merchant and packaged.

Now our team has done a fabulous job making sure that we remain ahead of the curve as far as inflation is concerned. We've been telling you this for about two quarters now and I expect that team to continue to do that as we move forward.

So, for us, making sure that we are working that pricing lever, having those conversations with our customers, as we see those inflationary trends continue to come through, it remains right on top of mind for us.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Thanks very much for the color. Appreciate it.

Operator: Thank you. Our next question comes from Vincent Andrews from Morgan Stanley. Your line is open.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Just a question, that the $1 billion of base CapEx that you talked about. Could you just talk to us about sort of what – how sort of robust that menu of opportunity is and why you choose it to be $1 billion versus why isn't it $500 million or $2 billion? As far as the eye can see, how do the returns there compare to the traditional CapEx backlog?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Sure. Vince, that's a great question. I'm glad you asked that question because I've been itching to talk a little bit small onsite. So, that's a good lead in there. So, let me first just describe that.

So, essentially, when we have projects, and I think small onsite is a great example to just illustrate the point. Here we have long-term contract. So, these are contracted. We have kind of secured cash flows in there. But individually, these are less than $5 million each typically or what we call our small onsite. And they have shorter execution timelines, they're accretive, good solid returns. These are projects we'd love to do every day. And the reason I want to particularly talk about it today also is because in the first half of this year, we did more than 25 of these projects already. We've signed up more than 25 small onsite projects already. Now, that's a 50% jump over last year. Same period last year, we are more – 50% higher than that.

And I love these subjects because great solid returns, good, strong execution, these are packaged plants, so we can go in there and work on them very quickly and which is why we get that execution advantage as well.

And I think the other point to just make over here and while I – on most points, I think we think about the merger being over, and that's true, but here's an example of revenue synergies that we talked about. We never really kind of – we never really put a number to it, but this is a good example of how the revenue synergies from the merger are flowing through. But we brought in two suites of technologies giving us a really strong position in that space, and we're leveraging that actively in kind of winning these deals that you see us put through. Now, all of these come through that base CapEx piece.

So, am I excited about that number of $1 billion? I am. There isn't a cap to it. And that flexes with what the business does and what the needs of the market are. And, clearly, we will flex that with what we see in the market demand. All it needs is, those investments have to meet our investment criteria. That's all it needs. Good quality projects, any day, anytime, happy to do, small or big. I hope that answers.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

That was great. And maybe just as a follow-up, and I might be reading more into this than I should, but now that you're combining sort of the sale of gas backlog and the sale of plant backlog, it feels to me you're just sort of bringing the sale of plant business a little bit more to the front of the stage than perhaps it's been in the past. And I see clearly that that's a lower margin business, but it's obviously a CapEx-light business versus the sale of gas.

So, I'm just wondering, am I correct that you're kind of thinking about the engineering business having more prominence on a go-forward basis and do you have a plan there to sort of improve the margins and the returns or is there more we're going to be hearing about it in the quarters and years to come?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

That's a great question, Vince. So, let me just take a step back, if I may, and just talk about the concept of how we think about our business and opportunities, right? So, the starting point for us is we want to be able to participate in the full range of opportunities that we see in the marketplace.

And to do that, I have a unique competitive advantage, which I am going to leverage, which is the ability to offer an attractive sale of gas model, or in some cases, where that customer, looking at those two models, is not particularly keen on that to be able to offer and get the business with the sale of plant model, right? So, either proposal for me works quite well.

Now, the profile is a little bit different. You're right in saying that during an EPC-type structure, for us is asset-light. It is ROC accretive. It's cash flow positive for us. So, we do think our engineering capabilities and the fact that we have those capabilities executing day-in and day-out at a tremendous level is a really strong competitive advantage that we have. And we want to make sure that we leverage that as much as we need to.

Now, I do want to just make sure that you understand and recognize that beyond giving prominence to one or the other, these are two – these are kind of two options I have and I've used those options, where I need to and where I can, you know, exercise and do what's best for the organization.

Now, there are two kind of underpinning principles in there. One, I want to able to approach every opportunity in my space that I have the advantage and the ability to execute on. And two, I want to maintain discipline and my investment criteria and I think this is that unique advantage that we get, you know, bringing the two together.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Excellent. Thank you very much. Appreciate it.

Operator: Thank you. Our next question comes from Mike Sison from Wells Fargo. Your line is open.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey. Good morning. Nice quarter there. Historically, inflationary environments tend to be good for industrial gas demand. And I'm just curious, given where we're at in this inflationary cycle, do you think there could be sort of a step-up in the multiplier for demand for industrial gases as we head into the next couple of years?

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Hey, Mike. That's a good question. So, when we think about inflation typically, we spend most of our time talking about what happens to the pricing side. But, you're right, inflationary environment, we actually like inflation as you've heard us say before largely, because on the pricing side, we have the ability to pass it, you know, much of that inflation through our contractual structures onto the customers and also it's a good opportunity for us to open a conversation on pricing.

Now, typically when we see inflationary environments, we do see some industrial activity pick up and recoveries happen and constraints that lead to that inflationary environment. That's where we play actively. And yes, I think in some areas, we will see some of that play out into demand – on the demand side as well.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Kevin McCarthy from Vertical Research Partners. Your line is open.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Good morning. Sanjiv, I was wondering if you could provide an update on the Snam deal that you announced in December of last year to develop clean hydrogen projects in Europe. How is that partnership going in the early days? Is the paradigm to move inexpensive energy from Northern Africa up to the European Continent?

And if so, what are the barriers if any to making more substantial capital investments in that arena? Does it have to do with technology and production economics or perhaps more on the commercial side? Maybe you can flesh out how you see the future there.

Sanjiv Lamba
Executive Vice President & Chief Operating Officer, Linde Plc

A

Thanks, Kevin. That's a really good question. So, the partnership with Snam has gone well. And we are like minded in our view of how the market needs for hydrogen in Europe, in particular Mainland Europe needs to be met. And that's the kind of common understanding and common appreciation of what needs to happen is critical for that partnership development to move forward to getting something substantial happen.

Now, as with all good things, Kevin, these things take time. And there is, as you are aware, a lot of funding activity happening in Europe, as we speak. And as part of that, I think we are waiting and watching to kind of see how that develops. So, that's in terms of how the partnership itself is moving forward.

I want to just take a bit of time and talk about your other part of the question, which is what do we see as element that will either encourage or create barriers for some of these substantial developments to accelerate and get momentum.

And here – and, unfortunately, I'll be repeating myself a little bit here. But I've said earlier on that – to Nicola's question that you need a couple of things to be happening in tandem, right? One, you need to see the regulatory environment with some steep come into place in Europe. We do have that.

But I must admit at the same time that it is complex. I won't say bureaucratic, but it's almost that. It has a number of administrative controls. It goes through a country process first, then at the European Union level, and then some allocations will happen. And there's a whole suite of activities that need to happen before some of that funding and incentives become actually available for you to be able to go out and make these substantial developments happen. So, there is that whole piece that is just – it's part of the process.

On the technology side, the other piece that I mentioned, you need a roadmap where you can develop on the assumptions. And Europe's kind of chosen the path of green. My view is that scale will happen on blue hydrogen before it happens on green. There is absolutely no doubt in my mind that that is true today and will be true for a number of years to come. Technology for scaling up on blue exists today. Linde provides that whole suite of technologies today to be able to do that.

So, on the green side, which is where Europe's kind of moved forward and I won't say selected, but certainly lean towards, we will need to see that technology development to scale happen. I think that is the technology roadmap that's kind of three to five years out. You need low-cost renewable energy. Again, that's a development that's in progress and not available everywhere in Europe, as you know, which is why this whole concept of Africa becomes so attractive and Northern Africa, in particular.

And you also need effective technology roadmap for the electrolysis to be able to bring that capital and efficiency up to a point, so capital down, efficiency up to get to a point where you can then create a cost advantageous position for green. I see those as both work-in-progress. We are actively involved in all of those activities as we move forward. But it is a still work-in-progress.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Very helpful. Thank you, sir.

Operator: Thank you. And we'll take our last question from Laurence Alexander from Jefferies. Your line is open.

Laurence Alexander
Analyst, Jefferies LLC

Q

Good morning. Can you just elaborate on the discussion around pricing? Are you seeing existing onsite customers start reopening contract negotiations or renewals earlier than normal to get in front of the inflationary cycle?

Matthew J. White
Executive Vice President & Chief Financial Officer, Linde Plc

A

Hi, Jeff or Laurence, sorry. It's Matt. I would say no. Things are pretty consistent with as you'd expect. I mean, normal pattern is usually two to three years prior to the expiration. You begin to talk about the renewal and any type of inflationary environments usually don't have any impact on that.

Laurence Alexander
Analyst, Jefferies LLC

Q

Okay. Thank you.

Operator: Thank you. And that does conclude our question-and-answer session for today's conference. I'd now like to turn the call back over to Juan Pelaez for any closing remarks.

Juan Pelaez

Vice President-Investor Relations, Linde Plc

Crystal, thank you. And thank you everyone on the line for participating in today's call. If you have any questions, feel free to reach out. Have a great day.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. And you may now disconnect. Everyone, have a wonderful day.