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# EDITED TRANSCRIPT

LIN.N - Q2 2019 Linde PLC Earnings Call

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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Second Quarter 2019 Linde Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Juan Pelaez, Director of Investor Relations. You may begin.

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### Juan Pelaez - Linde plc - Head of IR

Thank you, Nicole. Good morning, everyone, and thank you for attending our second quarter earnings call and webcast. This is Juan Pelaez, Head of Investor Relations, and I'm joined this morning by Steve Angel, Chief Executive Officer; and Matt White, Chief Financial Officer.

Today's presentation materials are available on our website at [linde.com](http://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 pro forma numbers are in the Appendix to this presentation. Steve and Matt will now give us an update on Linde. We will then be available to answer questions.

Let me turn the call over to Steve.

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### Stephen F. Angel - Linde plc - CEO & Director

Thank you, Juan. This is our first full quarter operating as one company. As you can see, we posted strong financials and raised guidance again for the full year. I'll come back to our expectations for the second half later.



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

The sale of gas backlog of \$4.7 billion has increased considerably as a result of the ExxonMobil Singapore project added this quarter. The Linde Engineering third-party backlog also remained strong at \$5 billion, bringing the total amount of project work to nearly \$10 billion. We think a 50-50 relationship between sale of gas and third party is a nice balance. Our focus continues to be on sale of gas, but we certainly want to take advantage of all the good third-party business available to us. The sale of gas project proposal pipeline still has some momentum driven primarily by petrochemical activity in the U.S. but also in Asia.

Some milestones during the quarter. We deployed \$1 billion to shareholders between dividends and share buybacks. We completed our squeeze out of the remaining shareholders of Linde AG. We closed on our South Korea divestiture and have reached agreement on one of the Indian divestitures. We now expect the value of our Asia divestitures to be in excess of \$1.7 billion, which is higher than originally anticipated.

We are making good progress on our cost synergies and restructuring initiatives. As expected, the time line is more extended in regions like Europe, where we need to engage the works councils on our restructuring plans. Having said that, discussions continue to be constructive.

Integration is going well: The organization is set. Voluntary turnover remains at low levels. There is a high degree of energy and collaboration. The organization is adapting well to an accelerated, operating rhythm. We have early wins we can point to in practically every area. There is a strong pool for best practices, technology and client capabilities. In short, the organization is excited about the potential for our new company.

Regarding the macro going forward, I'm sure you're going to think I'm too cautious, too pessimistic. Maybe I am but this is a scenario that can easily play out. Let's start with Asia. Though a good result in Q2, I see more tepid volume growth going forward. China growth is slowing. The key PMI indicators are sliding. IP has been trending down, and key metrics, such as electricity consumed for industrial production was only 0.5% higher in May. And for the entire economy, electrical consumption was barely over 2%. China is slowing and so is the rest of Asia. The good news is project start-ups will provide some nice lift for us beginning next year.

Europe. I see weakness across the Eurozone. Industrial production for June was negative 1.3% year-over-year. The fact we serve diverse end markets mitigates against this impact, and we had a good self-help story. But the macro headwinds are clear.

The Americas. Solid quarter in Q2 as pricing and merchant volume growth buoyed results. However, cylinder gases volumes, which primarily serve metal fabrication markets, flatlined in Q2 as hardgoods turned negative. However, pricing continues to be a good story here. After a sluggish start on the year due to a shortage of Venezuela crude, hydrogen volumes are improving as refiners take advantage of favorable margin spreads. Overall, we expect slowing growth with solid price attainment for the remainder of the year.

Obviously, if the underlying global economy does well, we will do well. If it falters, we still have a resilient business model and a strong self-help story to sustain performance. My priorities going forward: best-in-class safety, compliance, sustainability and diversity, driving a successful integration and building a high-performance culture, synergy attainment, cost, CapEx and growth, and implementing best-in-class price management systems and a robust productivity initiative.

And now I will turn it over to Matt.

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**Matthew J. White** - Linde plc - Executive VP & CFO

Thanks, Steve, and good morning, everyone. Slide 3 provides the second quarter adjusted pro forma results. As a reminder, these figures are modified from U.S. GAAP in 2 ways: First, they are pro forma, which means periods are restated to assume an effective merger date of January 1, 2018, including removal of the regulatory mandated divestitures. Second, figures have been adjusted to exclude items not indicative of ongoing business trends, which primarily relate to purchase price accounting and merger and restructuring-related costs. We believe this format best represents the underlying trends and performance of the combined business. Sales of \$7.2 billion are flat with prior year but up 4% sequentially from the first quarter. Unfavorable foreign currency translation reduced sales by 4% from 2018 and 1% from the first quarter. While the U.S. dollar has strengthened to almost every global currency, the major contributors are the Chinese RMB, euro, British pound and Australian dollar. Excluding foreign currency, underlying sales increased 4% from the prior year and 5% from Q1.



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

Versus the prior year, we continue to see positive pricing, which is in line with globally weighted inflation of 2.5%. Volumes are also up 2% as project contributions and growth in Asia and U.S. are partially offset by softer conditions across EMEA and South Pacific. Sequentially, volumes are up 4%, primarily due to seasonal effects and higher project billings in engineering. And price increased 1%. As Steve mentioned, price management continues to be an area of intense focus throughout the organization.

Operating profit of \$1.3 billion improved 6% over prior year and 8% from Q1, and when excluding FX, up 10% and 9%, respectively. Operating margin expanded to 18.4% versus 17.4% in 2018 and 17.7% in the first quarter. Sequentially, we expanded operating margin by 70 basis points as we made good progress toward achieving the stated cost synergies. At this point, we are on track to reach the full annual run rate of \$300 million by the end of this quarter, consistent with our merger commitment.

Aside from the cost synergies, initiatives continue toward identifying and executing further value-creating opportunities in revenue and cost efficiencies. EPS of \$1.83 improved 12% from last year or 16% when excluding impacts from foreign currency. The leverage improvement over operating margin is primarily due to lower interest expense, lower tax rate and less shares outstanding. I anticipate net interest to steadily increase each quarter as we deploy the divestiture proceeds and, thus, increase our debt levels. However, effective tax rate should remain around 24% for the full year and share count should steadily decline with the repurchase program activity.

When comparing to the first quarter, you can see that net income growth of 8% is consistent with the operating profit growth, as interest and tax levels were stable with a moderate decline in share count. Note that EBITDA sequential growth of 3% is slightly less as we further align the presentation format, resulting in a minor reclass between cost lines with no effect to operating profit.

On top of delivering solid financial results this quarter, the Linde team secured additional future growth by expanding the sale of gas project backlog to \$4.7 billion. As a reminder, this backlog represents estimated CapEx spend for customer projects under construction and secured by long-term contracts that lead to incremental sales and earnings growth. The increase from last quarter is due to the inclusion of a recently signed contract in Singapore, partially offset by smaller start-ups in Asia Pacific.

In this quarter, we are also introducing a CapEx break down and return on capital metric. We intend to report these prospectively, so investors gain a better understanding of capital deployment and returns, 2 very critical metrics for this industry. The capital investments are broken into 2 categories: project CapEx, which represents spending for the sale of gas project backlog; and base CapEx, which represents everything else, such as replacement, maintenance, cost reduction or smaller growth CapEx that does not qualify for the project backlog. It's important to differentiate between these 2 categories since project CapEx is lumpy, with a high degree of certainty in returns, more akin to acquisitions; whereas base CapEx defines traditional uses, such as asset replacement and organic growth. Sequentially, you can see that project CapEx is up 21%, primarily from project timing and a rising backlog. Note that the \$200 million CapEx synergy target will be achieved through better base CapEx efficiency and asset utilization and improved procurement for all capital spending.

The return on capital metric represents a rolling average of after-tax profit divided by a capital base represented as net debt plus equity. The full reconciliation can be found in the appendix. Note that the initial 10.4% figure is fairly consistent with the average of the 2 predecessor companies prior to the merger.

Second quarter ROC of 10.6% is up 20 basis points in the first quarter, primarily due to higher profit on a stable capital base. Net debt of \$11 billion increased about \$3 billion from last quarter as expected, primarily due to the \$3.2 billion squeeze-out payment. Net debt should continue to rise over the next several quarters as we recapitalize the balance sheet to meet our single A target credit rating.

Please turn to Slide 4 for an update on the full year guidance. Full year 2019 EPS estimate is in the range of \$6.95 to \$7.18, an increase of 12% to 16% from prior year or 15% to 19% when excluding 3% currency headwind. This range is 3% higher than last quarter due to faster synergy achievement in Q2 and more confidence in our self-help actions looking forward. However, we still anticipate softer volumes in the second half of the year as we are seeing more planned customer outages with demand softening in certain end markets, such as manufacturing. Furthermore, global industrial production levels are leveling out or declining across most countries, which could have negative effects on packaged and merchant volumes. Of course, this is just an assumption at this time, and actual conditions will likely vary. Rest assured, if conditions are better than anticipated,

## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

we will not miss any volume growth opportunities, given our breadth of coverage and contractual nature of this business. Also note that while we aren't providing quarterly guidance at this time, I would anticipate Q4 EPS to be slightly better than Q3, given synergy timing.

In summary, if current volume levels remain stable or slightly improve, we would anticipate reaching the upper end or possibly above this guidance range. However, given the current economic environment, we believe it is prudent to remain cautious and manage the business accordingly. Despite these economic uncertainties, we have a unique foundation of synergy and efficiency opportunities, coupled with a secured, industry-leading project backlog to improve the business performance and quality.

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

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) And our first question comes from Nicola Tang from Exane BNP Paribas.

#### Nicola Tang - Exane BNP Paribas, Research Division - Analyst

The first was on pricing. Obviously, this has been a key focus for you since closing the merger. I was wondering whether you have now managed to fully offset inflation with those price increases, which I think in your prepared remarks, you might have said that you have. And then also how should we think about pricing going forward in a more potentially volatile volume environment?

And then the second question was on cash flow. I was wondering whether you could talk a little bit about the moving parts on the operating cash flow because it looks like the conversion worsened a little bit quarter-on-quarter, and I was wondering if you could explain what's driving that and also call off -- call out any one-offs or anything related to restructuring and other. And also remind us of phasing of other sort of exceptional items on cash flow this year.

#### Stephen F. Angel - Linde plc - CEO & Director

All right, so this is Steve. I'm going to take the pricing question, then I'm going to flip it over to Matt to answer the cash flow question. So regarding does pricing equal inflation, I would say in certain parts of the world, the answer is yes. You can see we averaged 2%. Up all, all in the Americas was 3%. We had certain businesses higher than that. And if you go around the world, there's kind of plus/minus around that number. I would say we still have some work to do in terms of making sure that all of our pricing actions at least offset the cost inflation that we've been seeing and will see going forward.

So that work is not done. I said in my comments, it was one of my key priorities going forward to have a best-in-class price management system. That entails much more than just a price versus a cost inflation number. It's how you manage pricing, contracts, product management, all of that. Matt?

#### Matthew J. White - Linde plc - Executive VP & CFO

Yes. Thanks, Steve. And just to add one thing to Steve's, Nicola, that while we showed 2%, that was a fairly strong 2%. It just happened the way the rounding and footing work that shows us 2%, so as per the comments, that's pretty much right in line with the 2.5% globally weighted inflation.

Regarding the cash flow, I think as you may have alluded to, I think the best way to probably look at this is what is the conversion rate of our adjusted EBITDA to operating cash flow. And we talked a little bit about this in the first quarter as well. And I'll talk to the operating cash flow on a half basis, first half because as you can imagine, there's some parts that move between quarters. So when you look at historically the last 5 years of both



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

predecessor companies, the first half of the year, you tended to see operating cash flow as a percentage of EBITDA at around 70%, 7-0. For the full year, that number was closer to maybe 77%. So as you could imagine, the back half is usually stronger, almost the mid-80s, and the front half is usually around 70%. So I think that's the benchmark we want to look at from a cash conversion ratio, if you want to refer to it that way.

So looking at our particular numbers, as you know, our adjusted EBITDA for the first half is about \$4 billion, and our current operating cash flow year-to-date is about \$2.1 billion. So applying that 70%, that would mean we're looking for more like \$2.8 billion versus the \$2.1 billion, so about \$0.7 billion short of where we'd want to be.

So why are we, right? I think that's the question. One half billion or \$0.5 billion is all these one-off merger costs. We've got almost \$400 million related to either taxes on gains, costs to do the divestitures, merger cash costs that carried over and some change in control costs that triggered acceleration of retirement benefits. There's another \$100 million of restructuring severance related. So those \$0.5 billion are really one-off in nature, and that's something that will subside here in the next couple of quarters, especially the merger related, and we'll have a little bit more restructuring in the next probably 18 to 24 months.

There's about \$100 million what's called contract liabilities, and what that really relates to is last year, our engineering business had significant prepayments from their customer base, which is a good thing. That's them managing the working capital quite well, but we've lapped that. Now they are executing and building some of those projects so that's about \$100 million of some unfavorable timing, but that is the nature an EPC-type business.

And the remaining \$100 million is some working capital that, frankly, we got to get after. That's something we've got to do better on. We've got a lot of initiatives internally. We're working towards that. So that last \$100 million is something that I'm personally focused on, Steve's focused on to kind of get back to the right levels. But I fully expect the second half numbers to start stepping up, especially as we lap a lot of these merger cash payments. And at this point, I see no reason why we're not going to demonstrate the legacy company average of the cash conversion rate from OCF to adjusted EBITDA.

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**Operator**

And our next question comes from Duffy Fischer from Barclays.

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**Patrick Duffy Fischer** - *Barclays Bank PLC, Research Division - Director & Senior Chemical Analyst*

Congrats on a good quarter. First question is just can you talk about with more focus on the backlog now as we get into 2020. How does that compare with the start-ups coming out of the backlog, 2020 versus 2019?

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**Stephen F. Angel** - *Linde plc - CEO & Director*

So Duffy, we have said that this was going to be a fairly tepid year in terms of contributions from large project start-ups, something on order of probably 1%, and I'm going to say 1% sales and EPS. Going forward, certainly the timing of start-ups says we're going to have a stronger 2020 over 2019, so here again, regardless of the macro environment, we do have a stronger backlog contribution in 2020. I would -- I'm looking at something more like a 2% contribution over '19 top and bottom. And then based on the strength of what we have going forward, I'd say probably, through a 2023 kind of time frame because I'm looking at a very big project start-up there, I would look for 2% kind of as an average annual growth rate, top and bottom, going forward. I think that's certainly in the cards. And again, that's compared to 1% this year.

So if you think about kind of the sales algorithm going forward, we have the macro, the underlying macro very much driven by industrial production. I think that is kind of a more of a questionable number by the day. But on top of that, we expect price management contributions. On top of that, we expect backlog contributions. And at some point, we're going to start to see more noticeable effects from growth synergies. So that's the way we look at it.

AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**Patrick Duffy Fischer** - *Barclays Bank PLC, Research Division - Director & Senior Chemical Analyst*

Terrific. And then one, a little bit more specific. On your hydrogen business, do you see a meaningful impact from IMO 2020?

**Stephen F. Angel** - *Linde plc - CEO & Director*

I would say meaningful in the sense that the Singapore ExxonMobil project in part is predicated based on IMO 2020. Again, where they are positioned in Singapore, marine fuels is a very important end product for them. So I would say that was certainly driven in part by IMO 2020.

But aside from that, I've looked at this before, we may have a few projects over a number years, principally in Southeast Asia. But in terms of what we see refiners do to get prepared for this, it looks to me like it's more a case of they have coker capacity or they're adding coker capacity. They're very comfortable operating cokers. They've been doing this for many, many years quite well. Some of them are looking towards more sweet crude feedstocks. Some of them aren't going to do anything. They're going to wait and see how it all plays out, so that's how I'd answer that.

**Operator**

And our next question comes from Mike Sison from KeyBanc.

**Michael Joseph Sison** - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Stephen, in terms of your outlook, given some of the cautiousness you outlined for the regions, you did 3% volume growth in the first, 2% in the third. Are you kind of seeing 1% to 2% as we enter the second half? Or maybe just give us your thoughts on what volume growth you need to get to the low end as well of your range for this year.

**Stephen F. Angel** - *Linde plc - CEO & Director*

We're actually seeing slower growth coming off of Q2. So you can say at best flat, but we're certainly cautious, as you can tell in my comments. But if you were to look at what would it take to be at the bottom end of the range and of course, you've got to be careful here because I don't know what currencies are going to do. So you have to take that out of the equation. The rest of that is much more controllable. But you would have to be -- I would say we would have to be in the negative, mid-single-digit range to really find ourselves at the bottom end of the range. It's possible. Certainly, things are -- when you woke up this morning, you probably weren't as optimistic as you were last week. But that's kind of the expectations. It's, I'd say at best flat and then certainly on the bottom end of the range, kind of a minus mid-single-digit volume growth rate.

**Michael Joseph Sison** - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then just in terms of the synergy, you talked about the time lines in Europe a little bit extended, but you've got a lot of early wins or so I guess in a lot of areas. Can you maybe highlight a couple of areas that could do better this year that gives you confidence in the second half?

**Stephen F. Angel** - *Linde plc - CEO & Director*

Well, I would say when you look at the whole synergy plan as we've been implementing it, certainly in places like Asia, we got off the mark very quickly. Momentum is still building. I think in Americas, we got off the mark pretty quickly. You look at a place like South America, they integrated very quickly. And in the U.S., we've been working, I think, at a satisfactory pace in terms of addressing actions that we knew we could take.

Europe takes a little bit longer. We knew this coming in. We need to have -- go through the works council process. It's a very detailed process, but I think it's very constructive. We're already taking initial steps with them. We've had a couple of meetings. It's moving forward. I don't have any

## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

concerns regarding our ability to do what we need to do, but we certainly need to work through the process and respect the process. And I think that's important, and that's what we're doing. We do have a strong team on the ground in Europe, and I'm confident that as we go forward, we're going to see the synergy attainment. I'm also -- feel confident that we're going to see other areas of the business perform better as well, including price management and including productivity initiatives.

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**Operator**

And our next question comes from Ben Gorman from UBS.

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**Ben Gorman** - *UBS Investment Bank, Research Division - Associate Analyst*

Just 2 quick ones for me, if that's okay. First of all, in terms of price competitiveness in the industry, I was just wondering whether you could comment on whether it's changed at all, particularly with the mid-tier peers, post the closure of the merger. And then secondly, just on the exit rate in terms of volumes. I know you gave a little bit of color a minute ago, but any indication as to whether the 2% was a strong or sort of weaker 2%. And maybe particularly in Europe, the areas leading that slight decline that you've seen.

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**Stephen F. Angel** - *Linde plc - CEO & Director*

Well, I would say with respect to competitiveness, there are strong competitors around the globe. And Europe has strong competitors, China certainly has very strong competitors. We have very strong competitors in the U.S., other parts of the world. So with respect to bidding and winning on new projects and things like that, it's a competitive environment, which is what we expected we would be in. We like, obviously, the capabilities we have and our ability to win with the capabilities that we have. But certainly, it remains a competitive market.

And can you help me a little bit with your second question? I didn't quite pick that up.

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**Ben Gorman** - *UBS Investment Bank, Research Division - Associate Analyst*

The second question's really about sort of the exit rate. So you sort of mentioned things getting slightly tougher by the day. I'm just sort of wondering whether the exit rate, particularly in Europe, is sort of already close to maybe down a few percent and on a global basis as well.

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**Stephen F. Angel** - *Linde plc - CEO & Director*

Yes. Well, no. I would say -- so exit rate. So as I'm looking at -- look at Europe. For example, the industrial production has been trending down. I think that's going to be the trend going forward. You have, obviously, the prospects of Brexit and the headlines, certainly on the continent, are not all that positive, so I think that is what we are facing going forward.

With respect to China, obviously the news that has come out says that I think we're going to be in for a tougher road going forward. If I could talk about it market-by-market, it certainly -- I think it's overall, going to be net weaker going forward. The Americas with respect to industrial production, manufacturing has been trending down as well. And so I -- it's not like it's falling off a cliff but it certainly has been a noticeable trend. So that's why I've said before I'm really more optimistic about our ability to manage pricing going forward than I am about the underlying volume fundamentals. And then if you look at a place like South America, where there was a recent positive news with respect to addressing needed pension reforms, it remains to be seen if they're able to really turn the corner with respect to growth, and we'll see. So that's kind of the global summary.





## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**Matthew J. White** - *Linde plc - Executive VP & CFO*

And I think, this is Matt, just to add just one point to that. When thinking about volumes, year-over-year on the back half, maybe a little more challenging. You may recall fourth quarter was worse than third quarter. There was a bit of a decline on perspective. So I think, thinking about it sequential might help, I mean as Steve had mentioned, Q2 as a base mark this year, sequentially, we are expecting some decline off of Q2, and I think for modeling -- on that perspective, that might be an easier way to think about it.

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**Operator**

And our next question comes from John McNulty from BMO Capital Markets.

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**John Patrick McNulty** - *BMO Capital Markets Equity Research - Analyst*

I guess 2 quick ones. Does the macro weakness that you're seeing right now, does that require or facilitate more cost cutting as you kind of look forward beyond just the synergy-related or efficiency-related programs that you've already got in place?

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**Stephen F. Angel** - *Linde plc - CEO & Director*

The answer, John, to that is yes. I mean as we look at areas that -- we've always had the philosophy that we need to be adjusting to market conditions. We need to be on top of changes that are taking place. That's a philosophy we've had for a long time. We've never really had done much in the way of big programs. I can think of one in maybe 20 years. But yes, in addition to the restructuring initiatives that we had outlined as a result of the merger, I'd also talked about a productivity initiative, which is kind of a continuous improvement, something that's very important for us to have going forward.

But certainly, as we see market conditions change, the expectation is that each geography will adapt, whether it's -- pertains to a merger cost synergy or not that they will be making the necessary adaptations. So that's something that we follow very closely when we do our monthly calls.

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**John Patrick McNulty** - *BMO Capital Markets Equity Research - Analyst*

Got it. And then I guess with regard to the merchant pricing environment, clearly getting some strength there and recapturing some of the inflation that's been nicking away over the last couple of years. But I guess are you seeing any volumes walking away? Or are you seeing any changes in behavior from your customers? Or is this something more that they're accepting of because of what you would do to get it?

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**Stephen F. Angel** - *Linde plc - CEO & Director*

I would say -- and obviously, this is something that not only do we -- are we careful to pay attention to here, but you can imagine at a local level, they are very much sensitive to volume walking away as a result, to perhaps too aggressive a pricing posture. I would say for the most part, I have not seen a loss of volume as a result of too aggressive a posture on price.

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**Operator**

And our next question comes from Peter Clark from Societe Generale.

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**Peter Anthony John Clark** - *Societe Generale Cross Asset Research - Senior Analyst, Chemicals*

Yes, 3 questions if I can. First one, actually, for Steve again. Price management, you talked about price up in all regions. Would that be all key territories? And I'm thinking here particularly of Australia, where your peer mentioned that pricing for them, at least, was down.



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

You mentioned Brexit. I guess there's not a tremendous amount you can do about a do-or-die Brexit. It's more about the customers. But what can you prepare for that? Because obviously, it impacts U.K. and continental Europe, pretty significantly.

And the third point, probably for Matt. The base CapEx, Matt, is running about 7% of sales. Now Linde always had a much higher maintenance CapEx for various reasons, but one of which was mix and an almost cylinder army or all the cylinders they had. Anyway, they said that was one of the reasons they had much higher maintenance CapEx. Just wondering if there's a structural issue that means that you won't get a base CapEx to where you were but clearly, you will improve on where in the world.

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**Stephen F. Angel** - *Linde plc - CEO & Director*

Okay. Peter, so I -- with respect to, let's say, markets that were unaffected by the merger, and you brought up Australia. Clearly there are others. We found, if I go back in my Praxair days, that we had certain geographies that did a good job with price management, and you can spend a day with them and see they really understood what was going on in the marketplace, what was going on with cost, what was going on with supply and demand and things that needed -- they needed to do to address that.

And so the whole idea is to make sure that we bring that same rigor, that same discipline, that same competency, that same organizational approach to every corner of the globe. And we have had -- I've had those reviews with Australia. You mentioned Australia, and this is something they have been working on ever since the merger. I expect to see positive results, not only out of Australia but out of many other countries around the world as we continue to build that muscle.

With respect to Brexit, the deindustrialization of the U.K. has been going on for a long time, so Brexit is not the point where that starts to happen. So clearly, that's an effect that we have been feeling for a long time in the U.K. What I think the team has done a great job of and will continue to do a great job of is building out resilient markets, more growth in resilient markets. And I'm thinking of health care, I'm thinking of food and beverage, I'm thinking of a myriad of applications that they have been bringing to the marketplace. So that very much has dampened the effect of the deindustrialization trend. And so I don't expect a big change coming out of Brexit. I certainly don't expect positive growth going forward as a result, but I certainly don't expect a big change.

And Matt, do you want to answer the base -- or I can answer, and you can answer.

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**Matthew J. White** - *Linde plc - Executive VP & CFO*

Yes, sure. Peter, just a couple of things, as you probably know, but just to make clear. Obviously, our base CapEx, as we defined it here, does include small growth. And that can also mean ECOVAR or VPSAs, standard plants as legacy Praxair called them. So to have an apples-to-apples comparison may not be the same across the industry.

But to your point when I look at legacy Praxair that had reported this out, we were on a \$750 million to \$800 million-type year run rate. So just thinking of that in simple terms, if you double that, that would be around \$1.5 billion, \$1.6 billion a year, if you felt the company size doubled. Right now, the run rate on Q2 is about \$1.8 billion. Of the \$200 million of CapEx synergies, a large portion of that would be dedicated to this area. This is an area that's getting a lot of focus. You saw sequentially, we had a little bit of a decline, but this is something we're going to keep working at. We tend not to look at it as a percentage of sales. More really, it's a detailed bottoms-up how we look at that internally, what projects we need.

But I can tell you reliability, as you know, is critical in this industry. That's not something we're going to compromise. But when we look at the other growth or small growth initiatives on things like cylinders, trailers, tanks, given the economic outlook we laid out, that's an area I would see probably less spending going forward. Those spend tend to correlate more to IP. So this is kind of how we'll look at it. But clearly, the CapEx synergies of \$200 million, this base CapEx is going to be an area of intense focus.



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**Operator**

And our next question comes from Jeff Zekauskas from JPMorgan.

**Jeffrey John Zekauskas** - JP Morgan Chase & Co, Research Division - Senior Analyst

In looking over your pricing in the various regions, if you compare your average prices to the numbers that came out of your competitor in Allentown, your price gains are smaller, particularly in Asia and Europe. What do you make of that?

**Stephen F. Angel** - Linde plc - CEO & Director

Well, you have to understand we've been working on pricing for quite some time. So if you go back over a period of time, you would see our price gains have been there year-over-year. You also have to take into consideration that we have -- every competitor has a bit of a different mix. If I look at Europe, we're half packaged gases. So the ability to move through pricing very much is through, I don't know how many -- probably a million transactions or so through those small welders. So that is the mix that we have there.

If we look at Asia, obviously, our mix is a bit different than some of our competitors. We have Australia, which is a very large piece. Australia and China are the 2 largest countries that we have that represent Asia. If I look down beneath the covers, which I think is always important because you've got to keep in mind what we're reporting is an aggregated number. But I can look at China merchant price, and it's 5% year-over-year. So that number is very strong. Again, we've got some work to do across the board to bring everything up to an expectation that we would have. If I were to look at the Americas for example, 3% number, but U.S. merchant is 6%, South America is 5%, packaged is 3%. And then if I were to look at Europe, I'd say it's pretty much -- a pretty strong 2% kind of price increase number.

But again, it's very much affected by what's going on in mix. And I'll give you another small example of that. If I look at our small business called refrigerants, that number is off quite a bit, and so -- year-over-year. So that all kind of fits into the calculation, but it's quite a bit's driven by mix. But we certainly have a focus on working on every aspect, every channel, every product, every market across the globe.

**Matthew J. White** - Linde plc - Executive VP & CFO

And Jeff, this is Matt. Just to add one thing to that to Steve's comments. As you can imagine year-over-year, calculating that on the pro forma bottom details, we do our best. But sequential, we tend to look at more intently, just given -- since the merger effective date, really Q1 and Q2. And I think on a sequential basis, you'll find numbers are more comparable. So I just tend to keep that in mind as we look forward.

**Jeffrey John Zekauskas** - JP Morgan Chase & Co, Research Division - Senior Analyst

And then for my follow-up. Your adjusted interest expense was \$35 million in the quarter, which I think is about 1% of your net debt. Is there something unusual in the \$35 million number? And what's a more normal number, if there is one?

**Matthew J. White** - Linde plc - Executive VP & CFO

Yes, Jeff. This is Matt. So obviously, we have a lot of cash that's earning income that we are managing around the world, so you have interest income that's netting against that. So we are flush with a lot of cash. As we lever up and do more distributions primarily through buybacks, you will start to see a shift and you will see higher net interest but then you'll see lower share count, and that's part of the recapitalization I mentioned in the prepared comments.



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**Operator**

And our next question comes from Steve Byrne from Bank of America.

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**Steve Byrne** - *BofA Merrill Lynch, Research Division - Director of Equity Research*

Would really like to hear your view on what you've learned most from the integration of these 2 legacy companies with respect to what has surprised you. Anything that you would note that's more favorable than you expected or perhaps more unfavorable?

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**Stephen F. Angel** - *Linde plc - CEO & Director*

Well, this is Steve. I would -- nothing really comes to mind that says this is less favorable than what we had hoped for. I would say as we get into -- for example, Linde Engineering has very strong capabilities, very strong discipline, strong record of project execution. Many people think that it's all large project-driven, but a good 40% or so is very small projects that they execute, day in and day out. So the capabilities, the strengths within that business certainly are obvious.

As I look at application capabilities, it's a story of where I would say that we've been very strong in things like oxygen, combustion. Linde's been very strong in areas like clean fuels, health care. We both have worked on food and beverage. We both have worked on digitalization. The combined capability is very positive. I would say that certainly, some technologies like cylinder tracking is something that legacy Linde was very much out front with. Specialty gas capability, legacy Praxair had good capabilities, Linde has excellent capabilities. Together, we have a much stronger portfolio. You get into productivity tools, we each develop productivity tools. Praxair, obviously, was very proud of the productivity track record but Linde has excellent capabilities, too. You just put them all together. That's why I said at the beginning that all the employees, the 80-some-thousand employees within the company are very optimistic about the potential of the new company.

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**Steve Byrne** - *BofA Merrill Lynch, Research Division - Director of Equity Research*

And Steve, you mentioned engineering, 40% are small projects. How would you split that roughly \$5 billion in backlog between gases and non-gases. Is that shifting one way or the other? And how do you view the value proposition of having both of those skill sets?

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**Stephen F. Angel** - *Linde plc - CEO & Director*

Well, if you look at the \$5 billion of backlog, I would say that today in that backlog, natural gas processing plants, olefin plants would be probably half or so of that backlog, maybe a little bit more. And then the rest runs the gamut of ASUs and HyCO and also some other small projects that would be part of that backlog number. I think having capabilities around the olefin crackers, there's certain examples that has led to pull-through of ASUs and other industrial gas products as a result of having that upfront project.

Clearly, when you're talking about ethane crackers and natural gas plants, the level of -- the level at which you engage the customer is higher, because clearly, there is an interest at the highest levels of the organization with our customers in terms of talking to us about those kinds of projects, because they're very critical to their processes.

So those are certainly positives that I can point to. I can also look at natural gas processing capability and point to where that is a good source of helium, which has been in short supply, continues to be in short supply. So having that upstream capability puts us in a very positive position with respect to capturing helium off of that process. So that's how I would address that.

**Operator**

And our next question comes from David Begleiter from Deutsche Bank.



AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**David L. Begleiter** - Deutsche Bank AG, Research Division - MD and Senior Research Analyst

Matt and Steve, just on the synergies, what are you targeting in the back half of the year now for -- on the cost synergies?

**Stephen F. Angel** - Linde plc - CEO & Director

Well, I said \$225 million was the approximate synergy number. We had a good quarter in Q2, so we made a good dent on that number. Matt has said that we're approaching -- will be at the full run rate, so you're looking at a run rate in Q4 of something like \$75 million kind of run rate, so Q3 will probably less than that, should be less than that, and I think that's the right way to think about it.

**David L. Begleiter** - Deutsche Bank AG, Research Division - MD and Senior Research Analyst

Very good. And just on the buybacks, how should we think about the cadence of the buybacks in the back half of the year?

**Matthew J. White** - Linde plc - Executive VP & CFO

David, yes, this is Matt. So as you can see, we are in the market every day as you probably see from some of the reports, and that's something we plan to continue to do, to be a participant every day. And when we find opportunities, we'll obviously take advantage of that. That means that the last few days have been a good example, where there may be macro events completely unrelated to us could be good opportunities to come in and repurchases the stock. But obviously, we have the authority, we have the cash. We're in every day and where there are times to be opportunistic, we will continue to do that.

**Operator**

And our next question comes from Laurence Alexander from Jefferies.

**Laurence Alexander** - Jefferies LLC, Research Division - VP & Equity Research Analyst

Just a couple of questions. One is with respect to the softer volume outlook that you flagged, how soft would volumes need to get for you to worry about the cadence of pricing slowing down?

And secondly, on FX, we normally talk about currency with respect to the translation effects on the P&L. At what point does the backlog get fixed from a currency perspective? That is if you have a large project during 2022, at what point do we pin down the currency that will be used for translation effects going forward?

**Stephen F. Angel** - Linde plc - CEO & Director

Okay. So I'll just take the first question. I think this is going to be something that we have to look at geography by geography, product by product, market by market in terms of understanding negative volumes and the impact that it can have on pricing. I think it's clear that if you had a substantial drop in volumes and that contributed to a high level of supply versus demand in the marketplace, that could put some downward pressure on pricing. So I think I'd have to look at that in term of where it's going to actually materialize with respect to what it would do. My view is we would still deliver some positive pricing even if it fell to a level like that.

Then I'm going to let Matt answer the currency -- how we handle currency and projects we have in the future.



## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**Matthew J. White** - *Linde plc - Executive VP & CFO*

Yes, Laurence, so as you know, when we make these investments, they're 15- to 20-year horizons. So throughout that time frame, currencies go up and down. And to account for that, we always embed in our financial analyses a sovereign and currency risk in every country we operate in. So we essentially mandate that the return can recover the known risks within those contracts. And obviously, if you can get upwards of 100% inflation coverage in your escalation, that has a natural balance on devaluations. Because usually, after a devaluation, inflation follows. So these are the mechanisms that we do to recover. Compound inflation on a local basis can often exceed the effects of the foreign currency translation over that same time period. So these are all mechanisms you do when contracting to ensure you get an appropriate return inflation coverage to mitigate against that.

As far as the actual execution itself in procuring equipment, whether it's turbomachinery in Europe or coal boxes in China, et cetera, we may or may not use derivatives on that 1-year, 2-year invoicing exposure. That would be translational -- or transactional, I'm sorry, to your point. So that's more of a derivative decision. But long range, we feel we have very strong contractual and return requirements to offset that.

I think we have time for one more.

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**Operator**

And our last question comes from P.J. Juvekar from Citi.

**P.J. Juvekar** - *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*

You mentioned that IP or Industrial Production is slowing down around the world. How quickly do you see that in your packaged volumes? And you also mentioned that hardgoods turned negative. Is that a historically harbinger of slower industrial activity?

**Stephen F. Angel** - *Linde plc - CEO & Director*

So I'll just take the last one. So when hardgoods turns negative, and in this case, you see less large equipment, large welding equipment being ordered and so forth, it just says that your customers are becoming more cautious about the outlook going forward. And typically, that would be the first sign. Then you start to see the consumables slow along with the gas volumes. So it's not like it fell 30%. So if you go back in 2009, that's what we saw in the United States. Hardgoods fell 30%. But it did fall to negative territory, which says that it's certainly not a positive indication with respect to growth rates going forward. Not falling off a cliff but it does signal a weakening trend.

Again, I think about cylinder gases as very much tied to industrial production, and I made mention the fact that in Europe, half of our business is packaged gases, so that's very much tied to the manufacturing economy, and you can look at the trends with respect to the Eurozone, with respect to more negative trends on industrial production.

And I anticipate the same thing as I look across Asia, that the trend for industrial production has been walking down. The PMI indicators for metals, chemicals has been walking down and, therefore, that just signifies to me that there's going to be some weakness ahead. Manufacturing certainly is weaker in China than it has been. And so therefore, that has a big effect on cylinder gases. But not just cylinder gases. Other products as well.

**P.J. Juvekar** - *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*

Okay. And then your energy backlog is roughly half of your total backlog. With energy prices down from peak levels, what does that mean for your future backlog?

## AUGUST 05, 2019 / 1:00PM, LIN.N - Q2 2019 Linde PLC Earnings Call

**Stephen F. Angel** - *Linde plc - CEO & Director*

Well, we'll see. But energy prices have been all over the place and, of course, you are talking about oil prices have been bouncing all over the place for the last several years, very volatile. Natural Gases prices have been down and staying down in the U.S. as there is an abundance of shale gas. That's something everybody is very familiar with. If I look at the types of projects that we're working on today, it tells me that there's still a lot of room to go in places like the U.S. Gulf Coast, a lot of chemical activity, but also refinery activity still continues to be very positive.

So the outlook, certainly with respect to the U.S. Gulf Coast, I think is going to be positive and again, more driven by natural gas than anything else. We talked a little bit about the impact of IMO 2020, and there is some impact. Clearly, that's the big Singapore project that we talked about. And there are some other projects that we're working on in Asia, both on the refinery side and also on the chemicals side, not massive, but I think could be significant as we go forward overall in the backlog. So I think it's still pretty positive environment, particularly if you look at the U.S. Gulf Coast.

**Operator**

Thank you. And this does conclude today's question-and-answer session. I would like to turn the call back to Juan Pelaez, Director of Investor Relations, for any further remarks.

**Juan Pelaez** - *Linde plc - Head of IR*

Nicole, thank you, and thanks, everyone, for participating in today's call. If you have any further questions, feel free to reach out to me directly. Have a great day.

**Operator**

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude today's program. You may all disconnect. Everyone, have a great day.

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