

# **Air Products and Chemicals, Inc. (APD) CEO Seifi Ghasemi presents at J.P. Morgan 2024 Industrials Conference (Transcript)**

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**Body**

Air Products and Chemicals, Inc. (APD)

J.P. Morgan 2024 Industrials Conference

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Company Participants

Seifi Ghasemi - Chairman, President and Chief Executive Officer

Conference Call Participants

Jeff Zekauskas - JP Morgan

Presentation

Seifi Ghasemi

Hi, good morning. My name is Jeff Zekauskas. I cover chemicals for JP Morgan in North America, and it's my pleasure this morning to introduce the management of Air Products. Representing Air Products is Seifi Ghasemi, to my right, who's the CEO. You may know Seifi from his years when he ran Rockwood. He joined Air Products in 2014, restructured the operations of the company, expanded its Asian operations over a longer period of time, and then is now engaged in two large unconventional projects to produce hydrogen in the United States and Saudi Arabia.

Accompanying Seifi is Melissa Schaeffer, who's the CFO, who's sitting in the third row, and Sidd Manjeshwar who is to my right. The format of our presentation this morning is fireside chat. So maybe where we can begin is Air Products has two very large projects that will take years to complete, whether it's 2026 or 2027, and the financial demands of the projects are significant in that your CapEx is $5 billion a year, roughly, maybe it's $5.5 billion. Cash flow is about $4 billion. You pay a $1.5 billion in dividends, and so you're going to be burning $2.5 billion, $2.8 billion of cash for at least the next two years. Your leverage level right now is 1.5, so as a base case that'll take it up to 2.5. Is that too much? Have you bitten off more than you can chew? Is that the right amount of opportunity and stress for your balance sheet?

Question-and-Answer Session

Operator

[Operator Instructions]

Seifi Ghasemi

Well, first of all, Jeff, it's a pleasure to be here with you, and good morning to everybody who is in the room, and all the people who are listening on the webcast. With respect to what you are mentioning, we do have the capacity, financial capacity, to absorb that because, as you said, our leverage right now is around 1.5. We do want to keep our A rating and we definitely still have a lot of room to lever the balance sheet before we get to the point that our A rating will become an issue, and in addition to levering the company there are significant amount of other levers that Air Products has with respect to cash. I think your calculation is right if you assume that all of the projects that we are doing would be 100% equity, there is possibility of financing some of those projects as we have done with the big projects that we have done like Jazan or like the Green Hydrogen Plan and therefore we feel very comfortable that we have the financial capacity to not only support our existing business and maintain our market share and gain new projects as we have been, but in addition to that do these two very big projects and maybe even more as we go forward. So we obviously do these calculations all the time. We are very engaged with the rating agencies who have a great deal of interest in terms of our leverage and all of that. And we feel very comfortable that we should be able to meet the requirements and continue with executing what we have told people that we are executing and more than that, if necessary.

Jeff Zekauskas

So when we get to 2026 when the company is maybe beginning the year at 2.5x. Does Air Products want to structure its compensation from the projects such that what it can do is keep its financial leverage at, I don't know, 2.5x to 3x, that is does your balance sheet affect the way that you attempt to monetize your two projects?

Seifi Ghasemi

Well, Jeff, as you know better than I do, you always want to have a so-called efficient balance sheet and the efficient balance sheet is that you have the capability to pay dividend because that's the holy grail I didn't want to touch and dividends the only way to go is going up so and the second thing is that if you have opportunities to do projects which have significantly good return much higher than your cost of capital then is nothing wrong with having a high leverage on the company. I mean we are a public company; we obviously want to maintain our A rating so we want to keep that leverage at around 2 , 2.5 during the years. But private equity they make their money by leveraging the balance sheet 8x or 9x.

Jeff Zekauskas

Yes.

Seifi Ghasemi

So fundamentally we at Air Products would like to have a very balanced view. That means we don't want to be zero leveraged and we don't want to be so highly leveraged that we would lose our A rating. So if we find that balance and that balance would be having a leverage ratio of somewhere between 1.5 to 2.5 or more depending on what you are actually doing.

Jeff Zekauskas

In the Louisiana project originally, I think Air Products thought it would sequester 5 to 5.5 million tons of carbon dioxide. But the project was put together before the Inflation Reduction Act was passed. And then the act was passed. And now I think the idea is perhaps you could sequester 10 million tons of carbon dioxide. How did you come to make that decision to put the capital to work to expand the scope of the project?

Seifi Ghasemi

That's an excellent question. Originally, we said we are going to sequester what we make at NEOM. And that was at the time, as you said before the IRA, where the incentive for sequestering CO2 was about $45.

Jeff Zekauskas

In Louisiana, yes.

Seifi Ghasemi

In Louisiana. Now that that is $85, it makes it more interesting to put carbon capture on more than just our new project. And that means that we do have the CO2 because we have a lot of esteemed methane reformers who are all around the Gulf Coast feeding our pipeline. Therefore, we do have to CO2 if the incentive is such that it makes it economical to capture the CO2 sequestered it and have blue hydrogen that you can sell at a higher price, it made a lot sense for us to increase the capacity of our CO2 sequestration. Plus the fact that our ambition is not to just build one project in Louisiana to build another one and all of that and therefore we said that if we are building the infrastructure to which involves a pipeline from our plan to this sequestration site and the sequestration well, well as long as we are doing it for 5.5 we know we have the CO2 incrementally it is not, it is additional investment, but it's not that huge, and it is much better to do that now, which means put a bigger pipe and a bigger well, rather than try to duplicate it later on.

So it became a reasonable decision to expand the capacity. It's just like when you're building a water treatment plan for a new project. If you know you are going to have a second one, It's much better to build a bigger water treatment plan better than build the duplicate later on. So that is why we have increased our capacity and we renegotiated these with the state of Louisiana about getting the porous space. We do have enough porous space so that we can sequester 10 million ton or even more.

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Jeff Zekauskas

Or even more.

Seifi Ghasemi

Yes

Jeff Zekauskas

And in Louisiana, you have a number of steam methane reformers. Order of magnitude, do they generate 2 or 3 million tons of carbon dioxide and then what you might do is build pipelines to the site that you've got?

Seifi Ghasemi

Sure. Each one of our steam methane reformers generates somewhere between 750 to 1.5 million tons a year of CO2 and we have four or five of them. So we actually have more than 2.5 million tons. So the concept that you are describing is very accurate that we can capture the CO2 from these esteemed methane reformers and sequestering and that would be a significant advantage for Air Products because then that will allow us to reduce our carbon footprint and make the company a lot more environmentally friendly than it already is.

Jeff Zekauskas

So if you were on your way to doing that, I think the tax credit at 5 million tons is about $425 million. The tax credits at 10 would be $850 million. Is it easy, would it be easy for Air Products to manage tax credits of those size?

Seifi Ghasemi

Yes, because the way the legislation is, is that if you have the tax credit, and you don't have enough income to compensate for the tax credit for the first five years you get that as cash.

Jeff Zekauskas

As a cash.

Seifi Ghasemi

And then after five years, you are allowed to trade that to people who make a lot of money and don't have the tax credits. So there is no issue with dealing with the tax credit.

Jeff Zekauskas

So I think that there is one Japanese utility today that's beginning to use ammonia, blue ammonia in its furnaces in Japan. And some companies wonder whether when 2026 or 2027 comes around, there's sufficient demand for blue ammonia. What do you think about that? Is that something that you worry about?

Seifi Ghasemi

Well, first of all, the demand for blue hydrogen, the kind of blue hydrogens that we are making, because a lot of other people are talking about blue hydrogen, but that is only 50% blue. We are capturing 95% of the CO2, so we have a very low carbon density. It's all about carbon density. Yes, carbon intensity. So the very low carbon intensity product that we are going to make in Louisiana. Obviously, one obvious application, and the easiest application is to take what you are making, which is high, low intensity hydrogen, they convert it to ammonia, because that's the only way you can transport it, to Japan and Korea. The easiest thing to do is to just load into the furnace instead of coal and reduce your carbon intensity. The Japanese government, the Korean government in accordance with the legislation and the ambitions that they have announced, they would require the companies to do there.

So whether it is '25, '26, '27, or '28, if anybody wants to get anywhere close to net carbon, net zero by 2050, they have to start now. So there is an obvious demand for the problem. But then one other thing that I think actually has the potential of being even a bigger use of blue ammonia is in the marine industry in shipping to use blue ammonia as a fuel for the ships to reduce the carbon intensity of the emission from the ships which is becoming a significant issue because people like Microsoft, Apple who want to decarbonize the biggest source of their Scope II and Scope III in terms of carbon intensity is the shipping of their product from Asia to the US. So they have a great deal of interest for the ships to reduce their carbon intensity because they get the benefit of that. And as a result, I think that would be another significant application for their use of blue hydrogen, which is, I had to use the word ammonia because people think you're an ammonia company. We are not. We're a hydrogen company, but the only way to transport the hydrogen is to make it into ammonia and transport. So we are getting into the ammonia business. We were in the hydrogen business, ammonia to me is like a pipeline from the U.S. to Japan to transfer the hydrogen.

Jeff Zekauskas

And for use of blue ammonia in Japanese utilities or Korean utilities, is this a drop-in product, or do the furnaces in some way need to be refashioned?

Seifi Ghasemi

From what we understand, I don't want to pretend that we know all of their technology, but it is a very easy condition.

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Jeff Zekauskas

But costs some capital.

Seifi Ghasemi

Yes, but compared to the cost of --.

Jeff Zekauskas

So in general when people buy natural gas from the United States or liquefied natural gas, what they do is they buy it at some premium to what natural gas prices are in the US. Do you imagine that that's the way that ammonia contracts will be structured over a longer period of time? And do you think that the buyers are willing to make long-term arrangements?

Seifi Ghasemi

Well, the thing is that, as I said, we are making hydrogen. And how are we selling the hydrogen that we make in the Gulf Coast through our pipeline to our customers? Whether it is Exxon or Celanese or Covestro. If we do it, let's say we are making hydrogen. The raw material for making hydrogen is natural gas. You basically pay for that because we don't want to take the risk. So our price to them fluctuates with the price of natural gas so again for these applications although it is in the form of the ammonia, we are setting hydrogen. Therefore, the contracts will be exactly what you said. That means here is the price for the hydrogen based on $3 natural gas. If natural gas goes to $6, then the price goes up. And natural, gas comes down the price goes up, so it will be selling hydrogen exactly the same way we are selling hydrogen today.

Jeff Zekauskas

So in order to execute the project, you need permits for a Class 6 well and now Louisiana will have primacy or they will make the decision rather than the EPA. Is the time that it takes for the permit to be granted, if it is granted, is that the largest risk to the project and the largest factor that influences the time frame of the project coming on stream?

Seifi Ghasemi

You're absolutely right and that is why it is a very positive development for us that the federal government decided to give supremacy to Louisiana because when the supremacy was with EPA and the federal government, they have to deal with all of the applications for Class 6 well for all of the United States. That means there is a long waiting list.

Jeff Zekauskas

Yes.

Seifi Ghasemi

Now that Louisiana is doing that, the rigor of the examination is not going away, but now Louisiana has to deal with the project in Louisiana, which is not as long a list as in the U.S. Therefore the amount of time is going to be compressed and therefore we think what might have taken 2.5 years will probably take 1.5 years. So that was a very, very positive development for our project.

Jeff Zekauskas

How do you proceed with, how do you determine how much capital you want to put to work in Louisiana while you don't yet have the permit? Does that affect the speed at which you deploy your capital? That is to wait or your decision making is independent because of so many things that have to be built?

Seifi Ghasemi

Well, the thing is that why wouldn't we get the permit? The basic studies that would determine that the porous space has the capacity to accept the CO2. We have already done that. We have done an off-system work and that has been done through the ages by the U.S. Geological Society and so on. The structure of the ground in the Gulf Coast of the U.S. has been explored by the old companies for ages.

Jeff Zekauskas

Yes.

Seifi Ghasemi

So everybody knows the geological structure. So the geology is there. This is why one of the biggest advantages of doing a project in Louisiana. A lot of people are talking about carbon capture here and there where they don't know the structure.

Jeff Zekauskas

The geology.

Seifi Ghasemi

So the geology is there. So if we do our homework properly, submit our permit property and demonstrate that you're taking the appropriate protection. There is no reason why we shouldn't get the permit. So as a result, we are moving along with the project on the basis that we are very confident that we will get the permit.

Jeff Zekauskas

So maybe what we can do is turn to NEOM for a moment. Is NEOM a riskier project than Louisiana or is Louisiana riskier than NEOM?

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Seifi Ghasemi

Well, I think I don't want to say which one is riskier, but I think it is a fact that you can make a much stronger argument about the demand for blue hydrogen than you can make for green because, say, well, blue hydrogen is maybe cheaper. I'm not so sure. But the fact is, for green hydrogen, it is such a new product. Nobody is making it at scale. All of the projects are 10-ton, 5-ton, 15-ton a day, while ours is 700-ton a day. And as a result, it becomes more difficult for people that get their arms around it about who is going to use this product. To us, it is obvious who is going to use the product because if you look at Europe and you look at their legislation that is not somebody's figment of imagination, it is actually law approved by the European Parliament. Then the only way that you can meet those requirements is through green hydrogen. Blue hydrogen does not meet those requirements. Therefore, we feel pretty good about new. And that is where we think is the market for the product from NEOM. We are not going to take the NEOM product to Japan or to Korea or even the US. It is all designed and it is a perfect location for serving Europe.

Jeff Zekauskas

Originally when the NEOM project was put together, it was thought that the total cost of building the ammonia facility would be $5 billion and you negotiated your ammonia price under those circumstances. When the costs were determined to be much higher than that, closer to $8 billion, was the ammonia price changed that you had originally negotiated or is it the same?

Seifi Ghasemi

It is the same. We negotiated the price for the ammonia in July of 2020 when the project was announced. The price hasn't changed and now one says well how does that mean? Does that mean that you're not going to make any money on the production side? I mean you have to be careful that there is the production that's a joint venture between us, the government of Saudi Arabia, NEOM, and ACWA Power. But 100% of the product is exclusive right of Air Products. So we take it at a certain price. Then what we do with that is our business, and what we make money is our business. So you say that the capital went up, now if the price is the same, these people are making a lot less money.

That is not correct. Why? Because at the time we negotiated, the whole $5 billion was calculated on the basis that it will all be equity, and you get a certain return on equity. Because at that time, nobody thought that under any circumstances, we would be able to finance that project. But then we were able to finance the project. That is actually one of the reasons that the capital went up, because you have to put all of the financing costs. But now that the project is 30% equity, 70% debt, and the debt is at less than 5%. Therefore, if you had equity in the project, even at the same price of ammonia, you are making a good amount of money on your equity.

Jeff Zekauskas

Thank you for that. What role is Air Products playing in the building of NEOM? That is, does the company have a special status in being able to bring the project to the market?

Seifi Ghasemi

The Air Products is building the facility. And the way we are building it is that we obviously have subcontractors who are, whom we have said, I mean, Air Products is not in the business of pouring concrete.

Jeff Zekauskas

Yes.

Seifi Ghasemi

So we obviously have somebody doing that, building the wind turbines, building the solar field. So we have a significant lumpsum fixed price contract for a significant part of the facility, but Air Products is the general contract. We manage the project, we engineer the project, its Air Products is engineering the whole thing, and we are supervising or construction management and all of that. So we are in charge of delivering the project, but we obviously use subcontractors in order to manage the whole thing because we don't have people who go and actually put the wind turbine together. But we are in charge of building the facility.

Jeff Zekauskas

So commonly chemical projects in the Mid-East are late. What do you think about the timing of what you're doing? And it's early days. Is this a project where maybe it's a year late or it's too hard to tell so early on?

Seifi Ghasemi

No, we are at the stage that we are basically complete with the engineering and we have had a lot more progress on construction than people think. We think we have a very good handle on the capital and on the schedule. Now if some geopolitical event happens that there is a wider war in the Middle East and so on, at least right now sitting here, I feel pretty good that we can deliver the 2027 that we have said at that time to [inaudible].

Jeff Zekauskas

From your point of view Seifi, when you think about selling green hydrogen to Europe, is this something, who do you think are the natural buyers or what's the natural end market and for them is it a good proposition to pay a premium for green hydrogen?

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Seifi Ghasemi

Well first of all, what is driving that whatever industry you are in, whether it is transportation, whether it is shipping, whether it is steel making, whether it is refining, all of the industry. If you put CO2 up in the air, you are going to get taxed. Therefore, everybody is incentivized to use the product to reduce their carbon emission because there is no other way to do this. This is what I keep talking about, that if you want to reduce the carbon emissions, the only way that you can achieve that is to use low carbon intensity hydrogen. You don't have any other tool or any other option. So if that is the case, if people want to comply with the law, if they don't comply with the law, what happens? They have to pay a lot of taxes. So in that case, they are going to look at the taxes and they are going to look at the green ammonia and say, well, either I pay taxes or I use the green hydrogen to reduce my carbon intensity. And that is how you price this thing at the end of the day.

Jeff Zekauskas

So commonly people buy LNG under 20-year contracts with escalators having to do with natural gas prices. When it comes to customers buying green hydrogen in Europe, in your opinion, would they want to buy it under 20-year contracts or 10-year contracts or five or spot? It is less predictable in trying to figure out how the green hydrogen market will work relative to the blue hydrogen market in the United States?

Seifi Ghasemi

Well, the green hydrogen market, if I was the customer, I would want to sign as long a contract as possible because the beauty of buying green hydrogen is that there is no escalation on the raw material which is used for making green hydrogen because the raw material is wind and sun. There is no escalation on the price of wind and sun. So the only thing that determines the return for us is the return on the capital. So if I'm a customer, I would want to make a deal with Air Products saying that look, you are, you want a certain return on your capital, you don't want to escalate that, right? So why don't you give me a 20-year contract and I give you an escalation for the variable labor cost, but then now I have a contract for 20 years, 25 years, 30 years where I know my energy price is fixed.

I am not subject to another war in the Middle East, I'm not subject to natural gas shortages, I'm not subject to any geopolitical movement. That is the attractiveness of green hydrogen versus blue hydrogen because you can buy blue hydrogen. But as we talk, if their price is dependent on the price of natural gas, which obviously has to be, then if anything happens to natural gas, and we have seen in the past 20 years, look at what has happened to natural gas, then you cannot rely on your energy costs. And in Europe, I think that would be one of the things that eventually will get people to be a lot more interested in green than blue. First, the fact that the carbon intensity is zero.

Jeff Zekauskas

So in the way that you imagine the financial returns from the two projects, is it fair to say that the blue project is more of a fixed return over a very long period of time, whereas the green project, it's difficult to know where it's going to start because there's just so little green hydrogen in the world.

Seifi Ghasemi

Yes, the thing is that is one of the reasons that we are getting punished is because we are refusing to jump in and start signing contracts with green hydrogen because we think as time goes by, the value of the product goes up because people are going to realize that wait a minute, there is no other option. But that is getting our investors very nervous about wait a minute where is the contract. And I say why are you looking at where is the contract. Look at the legislation and if the legislation is there and the demand is there at some point enough people will buy the stuff and if you're the only people who are making it then they are in a good shape, so but that's an obvious issue that is being debated and you know that better than any of us.

Jeff Zekauskas

So maybe in our remaining time we'll bring our conversation down to earth. When we think about Air Products' earnings in 2024 in order for Air Products to meet its own expectations it needs to earn more in the second half of the year than it will in the first. And there's volatility in helium prices. There have been various cost issues in bringing in sale of equipment at Air Products. There's volatility in Asian demand for industrial gases and different projects coming on stream. How do you feel about the year? Do you feel as well as you did the last time you reported earnings, or are you more nervous, or it's the same? Where do you stand?

Seifi Ghasemi

We have given people an estimate, and we have to live by it, right. On that one, I just want to clarify that where we gave you the original estimate in October of 2023, because we are on fiscal year, in terms of what we are going to do in 2024, I personally, and maybe I was the only one in the company, who was a lot more optimistic about the Chinese economy and about helium prices and volumes. That view was not shared by all of my people, but I had that view. I was wrong on both of those things. So when you're wrong, then you have to revise your estimate. I thought that the Chinese economy will do exactly what the US economy is. That is, that when you come out of COVID, everybody has saved money. They have a lot of money to spend. The COVID, especially in China, where people were cooped up, couldn't go anywhere for a long time, they would suddenly, there's this urge of traveling and spending money and all of that, which is what is keeping the US economy going and shoot us up. So I thought that will happen in space in China, therefore our business in China will go like a rocket.

And the second thing is that people would not violate the law and break the sanctions and bring helium from Russia into China, which is what they're doing. So on those things I was wrong and as a result we were too bullish because the guidance that they had given you was showing a 15% increase year to year. So as a result of that when reality demonstrated itself in the first quarter, we had to reduce our forecast for the year. And that's what we have done but we are very committed to meet that and the leverage that we have is obviously in the second half of the year, we have some new plants which come on stream, which will give us some strength. And besides that, what happens within Air Products is under our control. We can always control our cost and productivity. We can always take all of us to 20% cut in our pay in order to make our forecast. But fundamentally, therefore, there are things that we can do in order to deliver what we have told people to deliver.

Jeff Zekauskas

Okay, well, that's the spirit. Thank you very much for your presentation. Thank you for your attendance.

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Seifi Ghasemi

Thank you very much. Thanks, everybody. There you go.

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