

# **Air Products and Chemicals, Inc. (APD) Jefferies Industrials Conference - (Transcript)**

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**Body**

Air Products and Chemicals, Inc. (APD)

Jefferies Industrials Conference Call

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Company Participants

Sidd Manjeshwar - Vice President, Investor Relations

Conference Call Participants

Laurence Alexander - Jefferies

Presentation

Laurence Alexander

So good morning. It's Laurence Alexander with the Jefferies Chemicals team at the Jefferies Industrials Conference on the first day. And joining us right now is Air Products. And with us is Sidd Manjeshwar from Investor Relations.

Thank you very much for joining us and thank you, everybody, for listening in.

Question-and-Answer Session

Q - Laurence Alexander

Let's start with hydrogen. And I'll promise not to spend all my time on this, but can you just start with around the world state of play in terms of project discussions and funding, where activity is accelerating and where activity is pausing?

Sidd Manjeshwar

No, great question, Laurence. And first off, thank you to you and the Jefferies team for hosting us. And it's great to be here with our investors and see so many familiar faces in the crowd. I'm joined here by my incoming successor, Eric Guter, as well as Mun Shieh and Liz Thomas from the IR team as well. No, terrific question on the hydrogen side of things. Look, today, as you're all aware, we produce over 10,000 tons of hydrogen per day. We're the largest producer of grey hydrogen at globally over 110 facilities doing that for us. We've got a phenomenal rolodex of customers that rely on us each day. And we've been on this journey of decarbonizing hydrogen for several years. What's been really exciting over the last three years is, it's been a seismic shift forward for the energy transition in terms of supporting low-carbon hydrogen with the US IRA and all the other public policy support in Europe and other parts of the world. As you talk about, I'd say, the various project discussions, I think, what you've seen is May of 2023, we brought our first landmark project NEOM, the first green hydrogen project capable of producing 1.2 tons of green ammonia per year to FID, which was supported by 23 global project finance institutions. So, I think, if you think of various legs of this tool, public policy being one of them, I think, that's moving in some parts of the world at a faster pace than others. We're seeing promising signs of what's happening in the Far East, in Korea and Japan as well, which will support our blue carbon journey. And then in Europe, which will primarily be where our green hydrogen goes, we've already seen a lot of these Red II, Red III, the other delegated acts happen and then each country is now working through their funding mechanisms to support the decarbonization of hydrogen as well. But in addition, we're seeing customers sign contracts. We've gone through the price discovery of that with TotalEnergies signing the first landmark green hydrogen contract in size as well. But we're also seeing hydrogen being used by our customers in different use cases, which weren't necessarily being used before as a fuel, a feedstock or as an energy source, which is also really exciting. And when we spoke about the Far East, if you think about Asia, more than 50% of Asian power generation today is coal with blue ammonia being blended in there, that's another giant market along with shipping as well. So, I think, long story short, our customer conversations are picking up steam and we're getting a lot more reverse inquiries post the Total contract being signed, which is very exciting. And I think that proves out that the economics works for us as well as our customers. And human inertia with an organization is a powerful thing, with Total having a visionary CEO like us at Air Products, I think that's broken the bow and now you're seeing a lot more come down. But are you also seeing banks supporting the cause. You just need the right regulatory frameworks that people can then hang their hat on.

Laurence Alexander

And then second, can you lay out your priorities between blue and green hydrogen, green ammonia, green methanol, all the different alternatives. And to what extent are you aiming to capture spreads when shortages occur?

Sidd Manjeshwar

Terrific question again, Laurence. So, look, I think as it pertains to hydrogen, maybe take a step back and think of Air Products supporting low-carbon hydrogen. So, there are good blue projects and they are great and good green projects as well. I think it all comes down to location, location, location. And I think if you think of today's hydrogen market, there is the power of being a first-mover incumbency, right? We have 1,100 plus kilometer pipeline network in the Gulf Coast, the largest in the world. That has its real competitive advantages, right, because no one can suddenly just show up and replicate that. So being an incumbent and being a first-mover matters and I think we've taken that, the next step with our low-carbon journey. And what I mean by that is when you think of low-carbon, it all comes down to location, depending on the location in the world, we do different things. So, for green hydrogen, you need a ton of land, right, NEOM sits on 200 square kilometers plus of land, right? I mean, that's like Houston and Washington DC combined, right? Think of that, that's a large, large piece of land, which you can't just get access to. So, I think, being a first mover there was very helpful. We're roughly less than 200 miles from the Suez Canal, which means shipping that product to Europe also works. It's on a main shipping channel, so it has multiple use cases. And then the renewable efficiency or the attributes in that location of the world are outstanding, which is why we can produce the hydrogen at such a low levelized cost. So, that's why we did NEOM where we did. Now when we think of blue projects, if you've got access to infrastructure, geological sequestration infrastructure, and pore space, that's the key to developing a blue project. We did that in Louisiana. We've done that in Edmonton, both on our strategic pipeline footprints where we can service existing customers as well as new cases. And with Louisiana, the additional optionality of being able to convert that into blue ammonia to ship it to the Far East is another added benefit. And depending on the regions of the world where we get subsidies like Canada has given us in excess of $470 million in subsidies, the US IRA, 45Q supports $85 a ton. So I think what you've seen is first-mover, lock-up the locational advantage, get access to the pore space because that's the real premium, right? And you've seen others deprioritize certain pore spaces that they had. So, not all pore space is created equal, which is why when we made our capital update announcement in Louisiana, we expanded our scope there because of how good the pore space was. So, I think that's the way to think about it. Ultimately, we are a hydrogen company. Ammonia is a derivative for us to transport it. We do that even with SAF and other renewable diesel products where you need three to four times more hydrogen than a traditional refining asset. So for us, we're in the hydrogen business and we'll support that in its various forms globally.

Laurence Alexander

And then I guess you mentioned distribution a few times. How are you thinking about the related infrastructure investments in either distribution pumps, pipelines, conversion stations, how much of the $15 billion plus you'll be spending over the next cycle would be for those kinds of assets?

Sidd Manjeshwar

Great question, Laurence. So I think, look, the $15 billion that we're going to spend is broadly for our energy transition projects. At this point in time, we've told investors that we'll spend $2 billion on our downstream infrastructure, which we are continuing to develop. We've announced three port terminals of green energy import terminals in Rotterdam, in Hamburg in Germany as well as in Immingham in the UK, all supporting industrial clusters because that's where the largest demand is going to come from. Now, the other piece here, which is often lost on people is the technology aspect of it. The distribution is well and good. We are in that business today. We move it as a gas in pipelines, we move it as a liquid or trucks. But I think the technology aspect of it is what's not fully appreciated. And we've been on this journey for the last seven years. And what I mean by technology is the disassociation technology as well as the electrolyzer technology, right. It's not something that we read about in the Sunday Times and decided to go invest in NEOM and all these projects. We've been working on these things. We've got over 45 patents for blue and green over the last three years. Similarly, we're fairly advanced in terms of acquiring patents for this disassociation. But those are game-changers where, when we initially announced it, people were fairly negative and didn't fully appreciate why we were doing this and now several competitors have come and announced similar ventures. So I'm glad folks have woken up three, four years later since when we did it. But the key here is traditional ammonia disassociation technology, you lose 30% to 40% of the volume. We brought that to less than 10%, which I think is really, really a competitive advantage. Similarly, with electrolyzers, getting electrolyzers that work in size and scale and our proven technologies are critical and which is why we have our partnership with thyssenkrupp, which has been supporting our NEOM and other green hydrogen efforts as well. But I think as our offtake strategy continues to build and we'll have more announcements in the next several months, that will dictate how our downstream strategy happens because if you sell more to the, I guess, the transport world, you'll have to build a lot more infrastructure taking it all the way down to your hydrogen refueling stations. But if you're connected to a customer that's a large industrial consumer on a pipeline network, you can then stop after the disassociation, convert it into a gas and put into our pipeline network. So I think as we continue to solve that conundrum, we'll then formulate and crystallize more of that strategy for investors.

Laurence Alexander

And you spoke of like the offtake, so I have to ask about the Total arrangement. Can you give an update or clarify how much is locked in, what is variable on that agreement?

Sidd Manjeshwar

Yeah, I think, more than are we there yet on our journey with my kids in the back of a long road trip is probably what price we sold the Total contract question that we've got from investors and rightfully so. But I think, look, when you're in a new industry or you're proving out a new ecosystem, price discovery is a very critical aspect of it. What we can say is the minimum 10% threshold that we always commit to, but having two visionary leaders proving that ecosystem out where the economics work for us and them, I think is the biggest win for all of us as we think about both the companies being driven by a higher purpose looking to solve climate goals. Total came out with the RFQ for 500,000 tons that they're looking to decarbonize 10 assets of theirs in Northern, across Europe, primarily in Northern Europe. They haven't been specific about which assets in particular. But what you've seen there is we've signed a contract for 70,000 tons. It's very akin to what our classic contracts look like in terms of the duration. It's a long 15-year contract. You know green and blue hydrogen because you've got a natural gas pass-through feature, those contracts will look different from green hydrogen contracts where you don't have that aspect of it. Unfortunately, being a public call, we can't unpack the details of the contract, which everyone is really keen to learn about. But I think the stability and the long-term nature and resiliency of our business continues with this venture and you're seeing that and post this happening, we're seeing a lot more momentum and reverse inquiry from folks in the oil and gas world looking to decarbonize their assets across the board as well.

Laurence Alexander

And then a very high level question, if you look across the projects you have in the current wave, do you earn more or less if oil goes to 100 rather than 50? And then if you think about 2030, 2035, do you earn more or less if electricity benchmark prices are $0.10 or $0.02 per kilowatt.

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Sidd Manjeshwar

Very typical, Laurence, question, but a very topical one. So maybe take a step back, over the last 100 plus years, all the energy transitions that we saw from wood to coal to oil were driven by it being a cleaner source of power of energy and a cheaper source of energy. Since the 2000s and we've seen this with the proliferation of and penetration of renewables globally and now with hydrogen, it's primarily driven by public policy support, right? So let's put that in context. And what I mean by that is oil at 100 is always more helpful because now the competitive fuel that's replacing it looks a lot cheaper. But what's truly driving this is decarbonization and energy transition. So putting that aside, I think, when it comes to renewables and the power costs there, that I think is very topical here, because when you think of a green hydrogen project, generally 50% to 60% of the cost of green hydrogen project tends to be your renewable block or the cost there. But again, if you can produce power cheaper, you're going to produce a lower levelized cost of product, which everyone wants and though our products or our projects and we like to think is going to be the cheapest project, if you think of where you know you guys have done some analysis, several sell side analysts have done the analysis of what you think NEOM costs, and if you think of what a localized electrolyzer solution cost in Europe, you can see we're materially cheaper than that, right, which is helpful for all of us as consumers. But I think when it comes to the renewable block, I think the other parts of it, which we continue to work on and others are as well as you look to scale these businesses up is how much capital efficiency can you drive and operational efficiency, right. And then the locational aspect, which we discussed earlier on this chat about where in the world your renewable attributes are better drives that cost. But if you can drive the cost down to $0.10, you're definitely going to be producing a lot cheaper cost. And if you think of where European power prices have been over the last three years, you can see they've ranged from somewhere between EUR85 a megawatt-hour to over EUR300. So you can think about that versus $10 a megawatt-hour, what the cost advantage and the dynamics are.

Laurence Alexander

As you look at over the next decade, does Air Products need to keep a CapEx split between renewables and conventional industrial gas projects or is the split that we see just going to be driven by market demand?

Sidd Manjeshwar

No, good question, Laurence. So look as an A/A2 company, we produce over $3.5 billion of free-cash flow each year. We're not necessarily capital constrained. I think the pace at which the projects are executed drives some of the demands on our liquidity and free cash flow needs. But for us, when we look at projects, we globally look at risk-adjusted returns for our projects and the nature of the projects, et cetera. Because we're -- you've always seen with Seifi, over the last 10 plus years, he's delivered collectively as an organization, 11% EPS CAGR, right, though we talk about a 10% minimum return. So he always holds the organization to a higher threshold. And for our projects, what we look at is, it's not either/or, so we continue to invest in our base business, the most profitable base business today at EBITDA margins north of 42%. And we have got, last quarter, we brought over 20 new assets online in Asia. So we continue to win projects on more than our fair share in our base business. And we'll continue to look at green and blue hydrogen projects and other hydrogen derivatives that our customers need. I think it's driven by demand as well at some level. So we do both. And today, we invest over $1 billion in our biggest business. So I think I wouldn't look at the question as either/or , or a prescriptive 75/25 split, I think it depends on good projects and we'll keep investing in good projects as we see them.

Laurence Alexander

And then two questions about the JV model, just to nail this down was to keep getting asked them. First of all, in terms of leverage, how much leverage do you expect your JVs to carry?

Sidd Manjeshwar

I think this is one where I'd say it depends. And I think what I mean by that is, given the complexity of our projects, the different structural nuances to each of them, each of our JVs gets treated slightly differently. And unfortunately, I'm giving you a lawyer-like answer, it depends. But what I mean by that is two simple examples. Lu'an is a JV which where we consolidate it on our balance sheet and another large JV, which is Jazan, there it shows up as an equity affiliate income stream and it's treated slightly differently. So what -- NEOM, when it comes onstream, the production joint venture will likely be treated like an equity affiliate income while it's being constructed, it's fully consolidated on our balance sheet, not to complicate things, but it depends on the way our deals are structured and then the accounting treatment that comes out of it. But I think ultimately, with equity affiliate streams, we report a net income line with EBITDA. So there -- we're leaving some money on the table in terms of people applying the right multiple to our earnings profile. But I think when we structure JVs and it also depends on our JV partners, what their balance sheet strength is. So in certain aspects, we put project financings in place. So Lu'an doesn't have a project financing in place, right, whereas a NEOM and a Jazan has because certain partners of us tend to use that financing vehicle very effectively. And I think what's critical here is we've lived in a heightened interest-rate environment because of Central Bank hiking over the last two years. But despite that, what we tend to do very effectively globally is depending on the nature of the project in the region, we lean on our relationship banks. So NEOM, the financing there is construction plus 25 years of paper, very long-term and we've financed that for less than 5%. So, fairly, fairly competitive rates. And again, that's another very effective way where we've got multiple financing tools available to us and we use that effectively. Similarly, over the last two years, we've raised less than $4 billion in green bonds where we've been able to monetize some sort of a discount to our secondary trading levels because of supply-demand imbalance in the wall of green capital chasing fewer deals. And we were the first company to come out and put a sustainability framework for blue and green hydrogen projects, which has been very effective. So, I think, what you're hearing from us is we do what's the right thing for our investors to drive more value creation.

Laurence Alexander

And then if you invest in a JV that's in your equity affiliate line and then they buy a plant from you, how does that flow through EBITDA and cash-flow from operations as a sale and CapEx as a sale of plant?

Sidd Manjeshwar

So, I'm going to have to, that's one way I might have to phone a friend. We haven't had to deal with that at this point in time, but at the right time, we'll bring the right visibility to investors versus me getting over my skis and commenting on something because these are variable interest entities. They've got IFRS aspects of them like the Jazan, some places has gaps. So, there's a lot of complexity here. So generally, in certain transactions like we've done with certain, Jazan was treated as a failed sale. So that's why it was treated the way it was because at the end of asset life, we hand the asset back to Saudi Aramco. So ultimately what I'd say is follow the cash. The cash flow will show you where it shows up in the balance sheet at the right place though the accounting treatment might be different. Ultimately, the cash-flow line will show you where it shows up.

Laurence Alexander

And can we do a quick around the world on how you see industrial demand trends, any significant shifts in end-market conditions over the last couple of months?

Sidd Manjeshwar

Yeah. If you think about and maybe let's, as we do a State of the Union, maybe we can start out with Asia and move further West. You know, in Asia, we are seeing two structural issues. One is China, in particular being the largest part of that region, struggles with foreign direct investment. We've seen the chemical destocking work its way through, which has been fairly beneficial, but the foreign direct investment challenges continue. Because of geopolitical reasons and their real-estate troubles, the risk sentiment amongst the Chinese consumer is high, so they're not really spending and that we've seen those effects in our business. We've seen some green shoots in the electronics side. But again, one data point is not a trend line, so I wouldn't want to overcome it there. I think China things continue to stay fairly anemic and it's going to be a multi-quarter recovery there, which we are cautiously optimistic on. As it pertains to Europe, what I'd say, Europe, let's draw two distinctions here in Europe. One is the base business, the conversations around low-carbon adoption and industrial demand, I think that's really, really positive and things are progressing with a lot of momentum there. On the base business, within Europe, based on where different regions of the world are and our different countries within Europe are in their energy costs has dictated how their economies and their central banks, different central bank actions are driving different outcomes. So Northern Europe is doing well, Eastern Europe struggles. Again, we never comment on intra-quarter trends. So what I'm giving you is reiterating our commentary from our last earnings call, but what will be critical in Europe is how this winter plays out and what energy prices are. The last two winters have probably been one of the weakest they've seen in the last 40 years, which was helpful, but paying energy prices at 300 when they traditionally used to be at 50 is, will leave some scar tissue. So let's see how that progresses. But we're again, I'd say, more optimistic there, but as it pertains to our guidance, we've given your comments on how Europe is going to play out. Americas, we're not seeing any slowdown as yet, though every day that gets publicly litigated on every investor call with different data points coming out of different industries, but we haven't seen any softness as yet in America. And our hydrogen business is doing terrific. We have practically sold out of every molecule and that business is doing well, and even on our merchant segment, we're seeing good utilization rates as well as pricing.

Laurence Alexander

And then I have to, I mean, I guess it's a good place to close ask about the CEO transition, which will be very big shoes to fill for whoever comes in. What do you see as the main themes or structural issues a new CEO will need to address? And what are the right skillsets to watch for to say it's a good fit for what Air Products needs at this point?

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Sidd Manjeshwar

So, now you're really looking to get me into trouble, Laurence. Look, you heard Seifi mention this on our last earnings call that he's named a new management Board, which allows us to you know it allows us to have the right people at the seat at the table with him. You know, we've, today, there's nothing wrong with our business. We've got the most profitable business in the industrial gas space, it streamlines his direct reporting line, so it allows him to focus on certain things. And things he mentioned was, look, today, we've got a $20 billion backlog that we're executing, right? So delivering the projects on time, on budget is very, very critical. So project delivery and execution is someplace where he's going to focus on, developing the bench is a second place, and then the offtake strategy. As it pertains to the new management Board, we've got a terrific group on that new management Board. Each person is an absolute expert in that field. Collectively between that group, you've got over 230 years of experience. So, absolutely stellar group that will help Seifi guide the company over the next decade. But I think what you're also seeing there is -- and with the demands that investors have several folks on that board don't have a lot of external exposure, which is why Seifi said I'm looking to bring someone externally. I don't want to speculate, but the person that comes in, she or he, will have to play a supporting role to Seifi for a couple of years because he again articulated that he's not going any place. He wants to see the strategy through. So, someone that's supportive of the strategy and supportive of being a second in command for a couple of years would be critical, while also developing the management Board and collaboratively working across the Board. So, I think those would be the things. Let that search process take its due course and I don't want to articulate, is there a certain timeline, I think the key is finding the right person and the right fit and that will drive a tremendous amount of value-creation. But I think Seifi hears investor's feedback and that's a clear demonstration of it.

Laurence Alexander

Okay. Fair enough. And that's the time we have. So, thank you very, very much for the time today.

Sidd Manjeshwar

Sounds good

Laurence Alexander

Thank you everybody for listening in.

Sidd Manjeshwar

Thank you.

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