Linde plc 3Q24 Earnings Teleconference and Webcast - Transcript
October 31, 2024

Operator

Ladies and gentlemen, good day and thank you for standing by. Welcome to the Linde Third Quarter 2024 Earnings Teleconference and Webcast.

At this time, all participants are in a listen-only mode, and please be advised that today's conference is being recorded. After the speaker's presentation, there will be a question-and-answer session, and I would now like to hand the conference over to Mr. Juan Pelaez, Head of Investor Relations. Please go ahead, sir.

Juan Pelaez

Abby, thank you. Good morning, everyone, and thank you for attending our 2024 third quarter earnings call and webcast.

I'm Juan Pelaez, Head of Investor Relations, and I'm joined this morning by Sanjiv Lamba, Chief Executive Officer; and Matt White, Chief Financial Officer. Today's presentation materials are available on our website at Linde.com in the Investor 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 these adjusted numbers are in the appendix to this presentation. Sanjiv will provide some opening remarks, and then Matt will give an update on Linde's Third Quarter financial performance and outlook, after which we will wrap up the Q&A.

Let me now turn the call over to Sanjiv.

Sanjiv Lamba

Thanks, Juan, and good morning, everyone.

Third quarter results once again demonstrated the resilience and resolve of Linde employees across the globe. EPS, ROC, and operating margin reached new highs despite challenging economic conditions in most countries, but frankly, none of this came as a surprise. Some of you may recall that we anticipated sluggish industrial activity this quarter and it played out as expected.

Looking ahead, I have concerns regarding continued economic weakness. So, we've taken a series of proactive actions, including targeted cost reductions. Matt will provide more details on this charge, but it affects approximately 2% of the workforce globally and is expected to be mostly completed in the next few months. In light of these actions, it may be helpful to provide you additional color on the end market trends, which you can find on Slide 3.

Industrial related end markets have declined 1% to 2% sequentially from the second quarter. This trend is consistent with our prior comments, as well as the industrial related macroeconomic statistics; however, we did experience some positive growth over prior year, including in North America, which had almost 40% of global sales continues to be a bright spot. On-site and merchant volumes are slightly up in the U.S.

In addition, North American project activity continues to progress. This said, these positive trends contrast with most of EMEA and parts of APAC, primarily China. The combination of geopolitical tension and economic uncertainty has suppressed large ticket purchases, which tend to correlate with industrial markets, such as steel, glass, and chemicals. Currently, we don't see any meaningful catalyst to reverse this trend for the remainder of this year, and thus have embedded this view in our guidance. We believe this is the most prudent position to take at this time.

Conversely, consumer related end markets are slightly positive versus second quarter, with continued growth in food and beverage and stability in healthcare. Electronics was up high single digit over previous year. As expected, recovery in electronics continues to move forward, but at a lower clip. While recovery is slow, we fully expect electronics to provide sequential growth in the next quarter, including project backlog ramp ups. Taken together, these trends point to a stagnant or slightly declining economic backdrop; however, the combination of actions on pricing, productivity, and costs, combined with contractually secured project backlog and robust stock repurchases, continue to support our ability to deliver shareholder value, regardless of the challenges. In fact, our backlog in the third quarter hit $10 billion, as we signed our largest sale of gas project in company history. This contract with Dow Chemical is a testament to our disciplined investment approach to pursue and win projects in our core competence of reliable and cost-effective industrial gas supply.

Slide 4 provides more details on this $2 billion plus investment for Linde. Dow is embarking on an ambitious project to achieve net zero Scope 1 and 2 carbon emissions in their Alberta Canada complex through a series of initiatives, including fuel switching from natural gas to low carbon or otherwise known as blue hydrogen. We're proud to be selected as the industrial gas partner to provide atmospheric gas, low carbon hydrogen and services for both CO2 capture and off gas cleanup. For Phase 1, Linde's total investment is expected to be over $2 billion underpinned by a traditional over the fence gas supply contract that aligns with our investment criteria.

We expect this project to start up in late 2028. I think it's important to note the size and scope we are undertaking. It's more than just low carbon hydrogen production. The clean energy transition will draw upon several different Linde capabilities, expertise and product offerings since integrated gas management solutions are in greater demand. In addition to supplying Dow, this investment will enhance our existing footprint and provide substantial density for future extensions. In fact, we're already in conversations with future potential customers. All in, this project aligns well with our core strategy to pursue traditional industrial gas contracts with high quality customers in key geographic regions of industrial density.

Overall, we see a challenge economic future, but are well prepared. Linde is heading into this uncertainty with the largest sale of gas backlog in company history, an incredibly strong balance sheet and a lean and well-focused workforce with a proven track record and successfully navigating difficult conditions time after time. And while I may not be bullish on the global economy, I've never been more confident in Linde's ability to sustain industry-leading results while rewarding our owners.

And I'll turn the call over to Matt to walk through our financial results.

Matt White

Thanks, Sanjiv.

Third quarter results can be found on Slide 5. Sales of $8.4 billion are up 2% from last year and 1% sequentially. Versus prior year, engineering increased sales 2% from higher project activity and higher demand for LNG

infrastructure while both cost pass-through and currency translation are down 1%. As a reminder, cost pass-through represents the contractual billing of energy changes to on-site customers and has no impact to operating profit dollars.

Excluding these items, organic sales are up 2% driven by price increases. Volumes are flat as growth from the project backlog is mostly offset by weaker base volumes. As mentioned earlier, the global industrial environment remains stagnant as many economies continue to report flat to negative industrial production levels. Despite these trends, operating profit of $2.5 billion increased 7% from last year, resulting in an operating margin of 29.6% or 130 basis points higher.

Project contribution, price, and cost productivity drove profit growth. EPS of $3.94 is up 9% from 2023, or 10% when excluding the impact of currency translation. These figures exclude a $150 million net restructuring charge, which represents severance costs for a 2% workforce reduction in the regions most affected by weaker volumes. We anticipate full run rate savings to be recognized in the second half of next year.

Slide 6 provides an update on our capital management. Operating cash for the quarter was $2.7 billion, 8% above last year, and 42% higher than the second quarter. As anticipated, we saw significant sequential improvement driven by interest, tax, and incentive timing. I expect to maintain this OCF level for the fourth quarter.

Our capital allocation policy remains stable with $3.4 billion invested into the business and $5.1 billion returned to shareholders. In the third quarter, total CapEx spending is up 12% versus prior year, with project CapEx up 40% from executing the $7 billion sale of gas backlog, but base CapEx is down 4%. As a reminder, the Linde project backlog only contains growth projects underpinned by a customer contract with fixed fee returns that are protected with termination provisions. Our definition is unique and the most stringent across the industry. The base CapEx decline is from productivity initiatives as well as better aligning non-backlog spend with local market conditions.

I'll wrap up with guidance on Slide 7. For the fourth quarter, we're initiating an EPS guidance range of $3.86 to $3.96, or 8% to 10% growth from prior year. This range assumes an economic contraction at the midpoint since we have not seen sufficient indicators of near-term improvement. In addition, this range assumes no currency impact, although the U.S. dollar has strengthened noticeably in the last few weeks as we approach the U.S. Presidential election. The full year range merely incorporates the Q4 guide and thus becomes $15.40 to $15.50, or 9% to 10% growth excluding a 1% FX headwind. The top end was reduced by $0.10 from prior quarter since we updated our sequential economic assumption from neutral to a contraction. While no one knows for sure what will happen, we believe this approach is prudent for this environment.

In summary, global industrial activity has been weak, and we do not anticipate near-term improvement. In fact, geopolitical tensions and regulatory uncertainty only appear to add volatility and potential downside events; however, as Sanjiv mentioned, we're prepared for this uncertainty. We have the strongest balance sheet in the industry with the most disciplined project backlog at $10 billion, ensuring high-quality growth for years to come. We have a well-honed operating rhythm, enabling our employees to take decisive and timely actions for their respective markets. And we have the densest network across all three supply modes to capitalize on every growth opportunity. No matter what the future brings, I have confidence we will continue to deliver industry-leading performance.

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

Question and Answer Session

Operator

Thank you. And we'll now begin our question-and-answer session. (Operator Instructions). And your first question comes from the line of Mike Leithead with Barclays. Your line is open.

Mike Leithead

Great. Thank you. Good morning, team. I wanted to ask, you're guiding to economic contraction in the fourth quarter, and it seems like some of the cost actions you're taking this quarter, there's perhaps some incremental macro caution that you're positioning for heading into next year. So, can you speak to where in your business, either regionally or end market, where you're seeing the most macro pressures today?

Sanjiv Lamba

Mike, I think as I said in my prepared remarks, you would have heard that I think describing the world, there aren't many bright spots. So, really, in essence, we are seeing the European market, they may have more broadly clearly seen pressure, and that's reflected in the volume developments that we see in that market. We've seen China, where there was a short-lived euphoria around the stimulus. We know that the underlying industrial progression there is not reflecting that and unlikely to see a catalyst for change in the near term. So, bright sparks or bright spots, as I defined in those remarks, was really North America, primarily the U.S., which has proven to be very resilient thus far. And is that a high watermark? And we're hoping to see that slight sluggish or softness that we've seen hopefully move back into a more stable and steady growth rate.

We have other smaller countries, India would be a good example, where we're seeing consistent growth. We continue to be -- we are the market leader there; therefore we continue to be benefiting from that. Similarly, Mexico also benefiting, like India, from the nearshoring, reshoring strategies that people are deploying. So, across the world, we see broadly the industrial recession or industrial weaknesses that we've been talking about for many quarters now, Mike, as you would recall. This isn't new, and I think the actions we've taken now, really are a reflection of our view of what we see the challenges going forward, but also the fact that there has been this long weakness in the industrial space.

Mike Leithead

Great. Thank you very much.

Operator

And your next question comes from the line of Vincent Andrews with Morgan Stanley. Your line is open.

Vincent Andrews

Thank you very much and good morning. You announced a decaptivation of two ASUs in India, I believe, earlier in the week or last week. Are you seeing more activity there or interest there, just given the weakness in the economic

activity? Are customers looking maybe to get some assets off their balance sheet, or was that just something you've been looking at for a while and finally came to fruition?

Sanjiv Lamba

Vince, why don't I talk about that specific opportunity first, and then I'll give you a slightly broader view of what I see around decaptivation globally?

Let's start with the Tata decaptivation that we did. The plants were being constructed by the customer, who had sourced the plants from a competitor. They were very keen that Linda take over those assets, particularly because we were able to integrate them into our extensive network that exists today in Kalinganagar, Orissa, which is one of India's large steel enclaves. So, we were able to provide a very innovative solution, both from sourcing energy, but also providing safe and reliable supply from our asset network. Again, leveraging that network density that we often speak about. It's a great project. We have a longstanding relationship with the customer. The project meets our investment criteria and enhances network density. I couldn't have asked for a better combination of factors to come together when I looked at that. That is what we look for in decaptivation.

You might recall a few quarters ago now, we've done a decaptivation for one of our assets in Fujian in China, and all of these exact metrics of these conditions were satisfied for us to take that on board as well. So, broadly on decaptivation, I'd say to you, we probably every year, this is not new, every year, we assess anywhere between 8 to 10 opportunities for decaptivation. We are selective about the ones we pursue, because we see the ability to integrate them into our network and to leverage that benefit, both for creating great supply options for the customer, but more importantly, for creating value at our end as well. When network density is at play, we would certainly find these very, very attractive for us to take on.

Operator

And your next question comes from the line of Duffy Fischer with Goldman Sachs. Your line is open.

Duffy Fischer

Yes. Good morning. Question around the healthcare business. Earlier this year, you were pruning some parts of that. So, can you just walk us through what's been pruned and what are we anniversarying? When does that anniversary end? And is there more to come? And then maybe just a third one to tack onto that, what do you think the structural growth rate is for healthcare '25 and going forward?

Sanjiv Lamba

Thanks, Duffy. So, let's go back to the healthcare piece. Now, the headline over there is healthcare grew year-on-year, a small percentage, but it grew. And I think the home care part of our business, as you recall, Duffy, we have two elements to the healthcare business. Hospital care, which is a very stable business that we serve across the world, and home care business that we participate in specific markets; obviously, a large market here in the U.S. as well for home care.

Much of our pruning of the portfolio and cleaning it up was all around the home care business, largely in the U.S. That, I would say to you, has largely been completed. In fact, you might recall in the last call, I said by the end of the

year, I expect all of that cleanup to be completed. I think we will see that done by the end of the year. We are on track structurally to see growth rates between low single-digit to mid-single-digit in the healthcare space. That's kind of our expectation, and I fully expect the healthcare business to be there as we look ahead.

Duffy Fischer

Great. Thank you, guys.

Operator

And your next question comes from the line of David Begleiter with Deutsche Bank. Your line is open.

David Begleiter

Thank you. Good morning. Sanjiv and Matt, economic contraction in Q4, does that reflect seasonal slowdowns as well as perhaps longer-than-normal planned shutdowns, or is this over-involved, where you would normally see seasonally and even extended year-end planned shutdowns?

Matt White

Hey, David. It's Matt.

The way we think about it, to your point, it is sequential. So, to your exact statement there, we view it as a sequential contraction, and it would be across the base organic volumes. It would not be seasonal. As you know, we have a normal seasonal pattern. That we view as consistent, but if there are extended outages, we would view that as a weakness, right, because you tend to have an average outage for certain, could call it holiday periods. And when you see those extend on the front and the back end, that usually is because the customer may not have the order intake or the workload to work at a harder pace. And so, they tend to extend around outages.

So, it does not include seasonality. It is only the base volumes, but to that extent, we definitely could see people extending outages given that, but I do want to just make sure I state that we don't know if this is right or wrong. This is just the view that's in the guidance. Obviously, we're taking actions around it. We're getting ahead of it. If this does happen, we feel we're prepared. If we're wrong and things are better, then that would be a potential upside for us.

David Begleiter

Thank you.

Operator

Your next question comes from the line of Peter Clark with Bernstein. Your line is open.

Peter Clark

Yeah. Good morning, everyone. Yes, it's one on the target for the $8 billion to $10 billion investments. So, well done on finally getting Dow Path2Zero signed into the backlog. My understanding is that certainly some of your closer

relationships are getting very positive or increasingly positive on the space and maybe looking closely at signatures. Liara have been obviously very positive on U.S. blue ammonia. Equinor, I think, have got some financing in place, or some incentives in place in Europe. Both these companies are very close to you, particularly with BSF. You are in a free port feasibility study that has dragged out as well going on. Just if you can comment around that sort of scenario, because you've still got the $8 billion to $10 billion out there. You're halfway there, pretty much. You've obviously got some confidence you're going to get that target.

Sanjiv Lamba

Thanks, Peter. So, let's start off with just assessing where we stand against that $8 billion to $10 billion, will probably give you a slightly broader overview of what development we're seeing around hydrogen.

On the $8 billion to $10 billion, as you rightly put it, I feel pretty confident about where we are. We've signed up about half of that between OCI and obviously Dow Phase 1. Peter, you'll remember that Dow has a Phase 2, which we haven't obviously committed to just yet, but that'll develop in its own course. Alongside that, we are doing a lot of front-end work at the moment on a number of projects. You referenced a couple of those already. And as I see the developments around hydrogen more broadly, I feel pretty confident that that $8 billion to $10 billion number over the next few years looks pretty much intact and something that I feel confident about.

I will, however, just step back and give you a broader overview on what I'm seeing around hydrogen. And I think you'll probably see this as well. So, this shouldn't come as a surprise at all, but we have been talking about hydrogen developments and saying that there is a high degree of euphoria. So, what we're seeing today is indeed what we had expected. I would segment the hydrogen development into the following elements and say to you, you are seeing and hearing a greeting about a number of project cancellations getting announced recently. In fact, most of them tend to be around what we call renewable hydrogen or otherwise known as green hydrogen, and driven by a number of factors, but key amongst them, the fact that incentives are unclear, regulatory framework is still being threshed out.

Capital costs are elevated. People hadn't quite expected that or haven't done enough work when announcing projects early on to recognize that capital costs are on the rise. And last but not least, returns aren't as promising as people thought they might be. So, in many ways that initial euphoria is dying down and being -- getting a bit of a sanity check or a reality check. And what do you see as a consequence of that is substantive projects, high quality projects, which make economic sense are the ones that are still around. That's a good thing for hydrogen growth and development in the long term.

The good news is we are very selective on the projects we work on. And I feel pretty good about the projects that we currently are developing. Most of those, as you would expect, and as we've said before, are in the low carbon hydrogen space or what otherwise is known as blue hydrogen. The technology is mature and available and scaled up today. There is operating expertise around that and the end product is very cost competitive. All those factors become a key element when people are making decisions on how they manage their decarbonization projects, which are a challenge economically as you know. So, that's kind of where we see the trend today and I'm pleased actually that that reality check is in place, because that's what we need for substantive development on the hydrogen space.

Peter Clark

Thank you.

Operator

And your next question comes from the line of Jeff Zekauskas with JP Morgan. Your line is open.

Jeffrey Zekauskas

Thanks very much. Your sequential prices were flat. If you -- now we're in something of a deflationary environment, so if you exclude the negative pricing, if there was negative pricing in your onsite business, was it the case that price mix would have sequentially grown or maybe another way of saying it is did price mix sequentially grow in your packaged and merchant business during the quarter or was it flat?

Matt White

Hey, Jeff, it's Matt.

So, a couple of things I think, it's not an issue of onsite and I wouldn't say we're in a deflationary. I would describe it more as disinflationary when you think globally. Maybe China might be deflationary, but -- so we're still seeing positive pricing across all of our base gases; and as you know, when we talk about 2% globally, the way to translate that because we tend to calculate it primarily just for merchant and package, it's about double the number of what you're seeing in merchant and package. So, to your point, we still continue to see both positive sequential and positive year-over-year pricing there.

Clearly, something like helium, I think we all know the pricing there is a little more globally based on supply-demand and there it's maybe slightly declining to flat and that could have an effect on there. But also when you look within the quarters, you're just going to have some timing impacts. I tend not to be overly concerned on that. Certain contracts, you'll have anniversary dates that the increases happen, so you can see some timing and lumpiness. We still feel quite good about fourth quarter, where we stand and where we'll be on that. So, I'm not overly concerned. I think our pricing still continues to track with the globally weighted CPI that we see in our regions. And I think the disinflation will have a little bit of a lower number at the global level, but it'll still be positive, and it'll still contribute.

Jeffrey Zekauskas

Thank you very much.

Operator

And your next question comes from the line of Steve Byrne with Bank of America. Your line is open.

Steve Byrne

Yes. Thank you. You're going to build this ATR for Dow, and you're going to reform T3 and T4 alkenes, not hydrogen-dense methane. Have you designed an ATR like this before? And if you need or want more hydrogen than will be required by Dow to heat their crackers, will you have the ability to reform natural gas in this ATR if you develop your own network of hydrogen customers in the area? And then just lastly, is this whole approach of reforming cracker byproducts, is this something you could see potentially employed down in the U.S. Gulf?

Sanjiv Lamba

Thanks, Steve. Great question.

So, I think this is where Linde brings a huge amount of value, our ability to provide a technical solution that integrates various technology packages and kind of provides whatever is required by the end customer. So, you've clearly spotted that. I'm going to just maybe take a minute and talk through what we're actually doing. So, on the ground, we're going to put two large assets to your point earlier. There is an ATR of $300 million a day, let's say, which is going to process natural gas; and as you would expect normal ATRs to do, and provide hydrogen as a consequence of that. As you know, from an ATR technology perspective, the autothermal reformer provides very high concentration, high purity CO2 off stream. So, capturing that CO2 is the next step in our process, which we can do coming out of the ATR very easily. So, that's one piece to your point.

Have we kind of designed these before? Yes. We are actually operating one in clearly today and have been doing that for about four to five years, in fact; and it's, in fact, if anything, hold the top, so we provided that technology package, bring a lot of their customers, because it's one of the best running ATRs anywhere in the world. So, feel very good about the technology, having designed it before and we are currently building it also at OCI. So, have a good track record on that. Feel good about the ATR technology overall.

Add on to that the second technology package, which is a PSA unit that we put in, which takes the off gas. Again, as you rightly pointed out, we will process the off gas, we will clean it up, we'll provide that clean hydrogen back to Dow and we will provide the rest either as fuel or if there is CO2 coming out, we will capture that as well and provide that for sequestration to Dow as well. So, again, integrating that PSA unit plus the ATR is a very smart way of providing a great technical solution. The point you made on the Gulf Coast or Texas, we actually already do this in the Gulf Coast. So, we have a track record of having built these PSA units to take off gas coming from the cracker, clean it up, and provide it back to the customer. So, we are actually applying some of those learnings that came out of that and creating a really, really solid solution here for Dow.

Steve Byrne

Thank you.

Operator

And your next question comes from the line of Stephen Richardson with Evercore ISI. Your line is open.

Stephen Richardson

Hi. Good morning. Sanjiv, it seems like we've had a bit of an acceleration of late on restructuring and potential exit announcements, particularly from European industry, chemicals and the like. Can you talk at all about any conversations you're having with customers or any how you think about that as kind of a risk or an opportunity from your assets on the continent? And how those discussions traditionally go to the extent that you do have customers that do want to shut down or restructure?

Sanjiv Lamba

So, Steve, you're absolutely right that in the press you read a lot about some of these proposed actions that large companies are taking. I can only tell you that currently we've not heard from any of our major customers in Europe discussing major closures. So, not to say that we don't keep a close eye on it. We are obviously tracking that very, very closely, recognizing the news that's in the air. But as things stand, we haven't had any of those conversations just yet. I'll also go on to tell you that, and I think you know this already, but let me reiterate that when the customers do decide to undertake that path of shutdown, we have solid contracts in place that will ensure that we protect our investment. And I think that's part of our model and that's part of the contracting discipline that we bring about in every project that we undertake. So, I feel pretty good about where we stand, at least in terms of protecting the interests of our investors.

Stephen Richardson

Thanks for confirming.

Operator

And your next question comes from the line of Mike Sison with Wells Fargo. Your line is open.

Michael Sison

Hey. Good morning, guys. A lot of companies have talked about '25. I know it's a little bit early to give specific guidance, but a lot have hinted that they felt the first half of '25 would be similar to the second half of '24, which, as you depicted, not great. Is that kind of what you see initially? And then when you think about '25 in general, is the growth algorithm, fairly similar? You've got pricing potential, backlog and stock buybacks for now?

Sanjiv Lamba

So, Mike, I'm sure you're keen to hear from us on what 2025 will bring, but you'll have to hold on to that for a while, because we'll come back in February and give you a very comprehensive view on that. As you might expect, we are internally putting a lot of energy into doing our planning for the next year. And I think those plan meetings are going to happen in the next three weeks. So, we'll spend a lot of time thinking about that, talking about that, and we'll come back in February and give you a much better view and a lot more granularity on how we see 2025.

Operator

And your next question comes from the line of John McNulty with BMO Capital Markets. Your line is open.

John McNulty

Yes. Good morning. Thanks for taking my question. So, a question on the sale of gas backlog. So, you more than doubled it. It's up almost $4 billion just from the last quarter. It looks like Dow is about half of that. I guess, can you help us to think about the other half and kind of how to think about the mix of projects that are coming in? And I guess tied to that, the Dow project is out relatively far for kind of your usual sale of gas backlog in terms of when it

materializes. Can you speak to the timing or duration on the rest of the projects that you just added? And if that's more traditional and comes in over the next, whatever, one and a half to two years?

Matt White

Hey, John, it's Matt.

Yes, so I would start with our traditional projects upon a signing announcement, usually it's about three years. That's, I would say, is a more normalized timeframe from announcement to completion and startup. Sometimes it can be a little accelerated if you have what's called an extensive reimbursable FEED where you're pre-ordering prior to announcement with reimbursement. But for the most part, I'd say it's about a three-year on a traditional project. Clearly, with some of the large clean energy projects and Dow being one, where our scope is much larger, hence the amount is much larger, they tend to be a little on the longer end, more like four years plus at times, just because the amount of scope we have to undertake is greater. So, to answer your question, I would say, yes, the remainder of the backlog would be more of a normalized three-year on average for contribution. And some of the larger clean energy projects could be more four plus because of the magnitude of the scope, but again, it's always going to be a function of how far along we are on FEED prior to signing of contract.

Sanjiv Lamba

John, I'll just add to tell you, to give you comfort that these projects, and you know my view on backlog, right? A shrinking backlog is a good thing, and that's what's happening this year. We're starting up about, I don't know, 29 to 30 projects this year. And we'll see about a $1 billion of that backlog or just over $1 billion of that backlog come out. And we'll, we brought in Dow at the moment and a few other projects come back into the backlog to grow it back up. So, that's exactly how we should be thinking about backlog.

John McNulty

Great. Thanks very much for the color.

Operator

And your next question comes from the line of Patrick Cunningham with Citi. Your line is open.

Patrick Cunningham

Hi. Good morning. Do you expect your capital allocation split to change in 2025 or 2026? I'm just curious on the path for repurchases over the next few years, given you've added some chunkier projects in the backlog.

Matt White

Hey, Patrick, it's Matt.

I'll start with the capital allocation process. No, absolutely no change, right? We view that as a long-term commitment on how we're going to allocate our capital. And so, from that perspective, we fully expect it to be consistent for our ownership base. Just as a reminder for those listening in of what our capital allocation policy is, I

can just reiterate it. We have an underlying mandate to maintain a single A credit rating and raise the dividend every year. So, that's our underlying mandate. And after meeting that mandate, our priority is to invest in the business using our investment criteria. That's where we want to put our capital, but the projects have to meet our investment criteria. And then whatever is left over are buybacks. So, we will continue to apply that approach. Clearly, as we generate more excess free cash flow, buybacks will naturally increase. But as we are seeing our sale of gas backlog rise, which it has now to the $7 billion, that means there will be more CapEx that will have deployment of capital to build these projects. We view that as a good thing. We view that as something for growth that meets our investment criteria. But from that perspective, I still right now feel our buybacks will be consistent next year with this year, just because of the excess free cash flow generation. And clearly, when there are opportunities, and today being one, we'll continue to take advantage of those as well.

Operator

And your next question comes from the line of Josh Spector with UBS. Your line is open.

Josh Spector

Hi. Good morning. I was wondering if you could talk about some of the moving parts in electronics. So, strong performance year-on-year, sequentially down slightly. You talked about improvement in the fourth quarter, but I'm not clear on your macro view if you're actually baking into the guidance or not. So, can you talk about what happened within the quarter and what's actually baked into your guidance? Thanks.

Sanjiv Lamba

Sure. So, the electronic sales, as you point out, Josh, are up 9% year-on-year. We've mentioned that we saw directionally electronics recovery go down the path that we had expected it to. It's maybe a little bit slower than expectations. So, from a more macro perspective, we see that in line with how expectations have been laid out. We see the investment commitments that have been broadly made by the large OEMs being in place as we look ahead to the midterm. What happened in the quarter itself, sequentially, I mean, the comment that you're -- or the question that you're asking about the sequential movement, sequentially gas sales were up. The difference here was that we have an advanced material business, AMT or LAMT, which also serves aerospace and electronics with some components. The electronics components saw some destocking in the course of the quarter, and we certainly expect that to get normalized in Q4; hence, the confidence we say that we will see electronics come back, solid growth sequentially because of gases continue to be on the path of recovery and seeing that normalization on inventory happen for those components that we provide out of the LAMT part of the business, which actually is reported in our global other segment, I think.

Josh Spector

Okay. Thank you.

Operator

And our next question comes from the line of Kevin McCarthy with Vertical Research Partners. Your line is open.

Kevin McCarthy

Yes. Thank you and good morning. At the top of the conversation, there was a lot of discussion about potential for macroeconomic contraction. I was wondering if you could speak to company-specific or idiosyncratic sources of volume growth from your project pipeline. If we think about the project contributions over the next four or five quarters, do you think they'll be similar to the last year or so, or higher or lower? Maybe you can talk about the next significant startups that you would anticipate over the next few quarters as well.

Sanjiv Lamba

So, Kevin, I'll give you a high-level view, and I'll let Matt give you a little bit more color on what we think from a numbers point of view as well.

So, from a high-level perspective, I'd say to you, within our project backlog are a number of secular trends. Electronics is a good example of that that I just talked to Josh about. We see that element of the backlog continuing to provide the growth and the startups happen as we would expect. We translate that, and I've said in the past, if you think about our EPS algorithm, about 1% to 3% of EPS growth will come from that backlog, and that remains consistent. I've also said previously that I expect that backlog to continue to grow. Certainly, you can see that evidence this quarter itself when we're sitting at that $10 billion number of sale of gas backlog of $7 billion plus. So, again, that backlog translates into contracted growth. We will see that come through.

I also mentioned that we see startups happen in the course of the year. This year, we said about 30-odd projects being started up, over $1 billion in backlog getting converted to revenues and earnings, providing that 1% to 3% of the EPS growth that I talked about. So, I think that's how we're looking at the backlog, thinking about it, some more secular. We are seeing some high-growth geographies also in our backlog converting to revenues and earnings. A good example of that are projects in India, in the more traditional end markets, which are also converting, getting started, and I think helping support the EPS growth algorithm.

Was there anything else, Matt, you want to add?

Matt White

I mean, yeah, I could just kind of add even for the color, I think, to start with, our algorithm, and Mike might've asked this question, I mean, we still -- it's fully intact; that's how we view that. And when you think about how we look at growing our EPS in this environment, I think a simplified way we think about it is three buckets. It's the management actions that we take, it's the capital allocation that we do, and it's the macro. And so, when you think about capital allocation specifically, that includes our project backlog, that includes M&A, that includes buybacks, because we're talking about EPS here, so that is a use of capital. And it also would include any capital structure that we may do in terms of having synergies on either interest or tax.

And so, consistently, that has been 4% to 6% sort of contributory throughout the last couple decades. And it's very stable, and it's unrelated to the macro, because these are either contractually committed that are independent from the macro, or it's a use of capital for the case of buybacks, where ironically, it's almost counter-cyclical. So, when the macro gets weak, we tend to have more free cash, and we have more opportunities for buybacks. So, we continue to have a high degree of confidence on that capital allocation and the stability it brings in the algorithm, and similarly on the management actions. That tends to be mostly price less cost. It's a function of productivity. It's a function of the actions we take in every local market around the world.

Obviously, getting ahead of that and having the right programs in place is important, but we continue to have a high degree of confidence in the contribution of the management actions as well. The macro is the piece that's base volumes and FX. Clearly, we're seeing the dollar strengthen here, just given some of the uncertainty, and a strengthening dollar, unfortunately, usually comes with a weaker macro. And so, it tends to be, I'll say, positively correlated that when you see currency headwind for us, it usually comes with weaker industrial production levels, and when you see currency tailwind, it usually comes with stronger industrial production. So, when you think about that algo right now, we are being cautious on the macro from what we're seeing, looking ahead, at least to the near term, but we continue to have tremendous confidence on the contribution from our capital allocation and from the management actions that we're going to take.

Operator

And your next question comes from the line of John Roberts with Mizuho. Your line is open.

John Roberts

Thank you. When you do a new ASU, I think of the baseload customer typically being about half the demand after you build out the enclave. And then when you build an SMR, I think of the onsite customer being 90% plus after you complete everything. You build an ASU and an ATR in these new projects here. Can you sell out all the excess oxygen, all of the nitrogen, the argon, and what would the original onsite customer be in one of these projects after you build everything out?

Sanjiv Lamba

John, that's a great question, right at the heart of the network density conversations we tend to have in the company quite often. And I think to your point on ASUs, we normally expect our anchor customer when we put an onsite in to take up about 70% or thereabouts, because that's kind of where we are able to operationally optimize the air separation plant typically. And then obviously we try and keep the balance to create the density that we need, go further downstream looking at merchant and potentially even package business and creating network density around that integrated model that we very often talk about.

The example of Dow, I think, which is maybe what you're referencing over here, where we've got an ATR plus the oxygen feeding into the ATR. So, remember over here, the surplus oxygen is quite little. There is some nitrogen available. Again, we are providing some of those atmospheric gases back to Dow as well for their consumption within their complex. So, it really is a great example of where we've been able to get the anchor customer to take a large part of the product slate, but we're also promoting density in the area given that our established footprint in Alberta, we are able to leverage that to be able to place much, in fact, all of that product fairly quickly on the atmospheric side.

We also have a little bit of extra hydrogen beyond what Dow will be taking, right? Dow is an anchor customer, and we will have surplus hydrogen leftover, which we wanted to be able to build out the hydrogen network that we expect to have in Alberta. And in fact, my expectation is, as I referenced briefly in my prepared remarks, is that we will build on that foundation that we've got in Phase 1 of Dow to actually add capacity and build a significant hydrogen network in Alberta in the future. So, for me, in many ways, this is, we're kind of literally building the foundation of what's going to be a very attractive network. Won't be at the same scale of what you see in the U.S.

Gulf Coast, but my vision is that that's kind of directionally where we want to take the hydrogen network for Alberta as well.

John Roberts

Thank you.

Operator

And your next question comes from the line of Laurence Alexander with Jefferies. Your line is open.

Daniel Rizzo

Hi. Good morning. Thank you. This is actually Dan Rizzo on for Laurence.

You mentioned the second phase or the next step with Dow, which you're not committed to, but I was wondering just kind of in a broad sense, is that like a magnitude larger if it were to happen after obviously, after this one is up and running?

Sanjiv Lamba

Right. So, I think there is an agreed timeline over which that decision will get made. Obviously, we've done a lot of initial planning and done some thinking around how that phase will play out. We would expect that investment to be just maybe a little bit lower than what we have in the first phase. So, as and when that decision happens over the next few years, we will hopefully see an investment of substance being put to build on the foundation that we've laid in the first phase.

Daniel Rizzo

Okay, and then you mentioned, obviously, finishing up pruning in healthcare. Given what's happening elsewhere in other regions, is there opportunity for doing some pruning or kind of divesting in other areas outside healthcare in different regions around the world, such as like Europe, where things are fairly soft still?

Sanjiv Lamba

We're always evaluating our portfolio and there is a lot of action that happens. Obviously, it isn't large enough for much of that to have a lot of visibility, but two pieces of that portfolio puzzle that I want to tell you about briefly. One is what we'd like to bring onto our portfolio. So, tuck-in acquisitions are something that we execute on consistently every year. We have a fairly healthy opportunity pipeline in that space. And in fact, we've brought on a number of those tuck-in acquisitions this year as well. So, we feel very good about the ability to bring them onto our platform, if you will, integrate them well and create value as a result of that. So, that's the incoming piece. Then alongside that, we're constantly looking at our portfolio elements and looking at where we divest. We've done that in the past, as you're aware, and you will continue to see us do that more broadly as well.

Daniel Rizzo

Thank you.

Operator

And your next question comes from the line of Tony Jones with Redburn Atlantic. Your line is open.

Tony Jones

Hey. Good morning, everybody, and thank you for taking my question. Just a quick one to squeeze into the end. Can I check my quick math that the new cost reduction can lift EPS by around 1% to 2% if it's all gained in 2025? And following up with that, is that incremental or will be part of the normal 4% to 5% EPS growth from price versus management actions? Thank you.

Matt White

Tony, it's Matt.

I'll start with, we expect this to be roughly a one-year return. So, you could do the math on that. And as mentioned in the prepared remarks, we expect the full run rate to take effect in the second half of next year. So, based on that, you won't get the full benefit in 2025, but we would anticipate, a majority of the benefit to be in 2025. When you think about, this action clearly is incremental. This is something we feel we need to take. It is a bottoms-up approach. So, each market aligned with what they're seeing in their respective regions and adjusting their costs accordingly, but we view this all part of this management action effort that we need to do to get ahead of this environment. So, clearly, we see it as beneficial, we see it as incremental the next year, but this is all part of the effort we need to undertake, as I mentioned earlier, because our outlook on the macro is a bit weaker, and so we view we need to make it up in some other areas of which management actions would be one.

Tony Jones

Thank you, Matt. That's very helpful.

Operator

And your final question comes from the line of Mike Harrison with Seaport Research Partners. Your line is open.

Mike Harrison

Hi. Good morning. You mentioned that big ticket purchases have been a little bit sluggish due to economic uncertainty. Can you comment on what you've seen in hard goods and equipment and automation demand in North America or other regions? And I'm curious, have you seen any change in customer behavior in response to lower interest rates?

Sanjiv Lamba

So, Mike, let's talk about the hard goods business first, and then we'll talk about interest rates.

The biggest hard goods market for us really is here in the U.S., and this is a trend we track very closely. As you've heard me say previously, I think of it as a bit of a leading indicator. We are right in the middle of the industrial weakness that we've referenced a number of times in this call, because the hard goods numbers are actually reflecting that. We see about mid-single-digit declines on hard goods sales. Now, that is split, and to your point, there are some -- when we think about that sequentially, there are some large automation purchases that swung one quarter to the other, so that I think does kind of change the numbers a little bit. But there is an underlying weakness on the hard goods side, I think, which is reflective of the industrial weakness we describe more broadly across the manufacturing sector in particular. And that's consistent with what we're seeing on hard goods elsewhere in the world as well, although our largest market is the U.S., as I mentioned to you.

A reference to also the large-ticket items, and I think which ties in with your question on consumer behavior, is that people across the world and I think I'll talk about the rest of the world and then I'll come to the U.S. market briefly. People across the world are finding that there isn't the propensity to spend, and decisions on large spend items just isn't happening as you would normally have expected. And that's particularly true of places like China, where consumer sentiment obviously is down, and a little bit in Europe as well, where people see that economic weakness and recognize that there isn't a catalyst that's going to change that in the near term. So, there is a degree of more caution that's reflected over there.

The consumer sentiment and behavior in the U.S. has been phenomenal. I think the economy has benefited tremendously from that. Obviously, we are seeing signals of some concerns around that, including some, if you think about auto loans and other areas, where delinquencies are on the rise. But we're not seeing anything to suggest that in anticipation of the Fed's actions, that -- that sentiment has become a lot more bullish. We haven't seen that, don't see that just yet. If anything, I think the consumer behavior does seem like it's tightening a little bit, but I'm happy to be proven wrong. And we'll see how this quarter plays out.

Operator

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

Juan Pelaez

Abby, thanks again for a great job today. Everyone else, thank you for participating in today's call. If you have any further questions, feel free to reach out. Have a very productive day. Thank you.

Sanjiv Lamba

Thank you.

Operator

And, ladies and gentlemen, this concludes today's call, and we thank you for your participation. You may now disconnect.