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GRA - Q1 2017 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 1Q17 sales of $398m and adjusted diluted EPS of $0.68. Expects 2017 sales growth to be 3-4% and adjusted EPS to be $3.30-3.45.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the W.R. Grace & Co. First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to introduce your host for today, Ms. Tania Almond, W.R. Grace Investor Relations Officer. Ma'am, you may begin.

Tania Almond - *W. R. Grace & Co. - Investor Relations Officer*

Thank you, Andrew. Hello, everyone, and thank you for joining us this morning, April 26, 2017. With me on the call are Fred Festa, Grace's Chairman and Chief Executive Officer; Hudson La Force, President and Chief Operating Officer; and Tom Blaser, Senior Vice President and Chief Financial Officer. Fred will start with the highlights, Hudson will review more detail on operations and Tom will go over the financials. Then we'll open it up for Q&A.

Our earnings release and corresponding presentation are available on our website. To download copies, go to grace.com and click on the Investor tab. Some of our comments today will be forward looking and are made under Section 27A under the Securities Act and Section 21E of the Exchange Act. Actual results may differ materially from those projected or implied due to a variety of factors. Please see our recent SEC filings for more details on the risks that could impact Grace's future operating results and financial conditions.

We will discuss certain non-GAAP financial measures, which are described in more detail in this morning's earnings release and on our website. Reconciliations to the most directly comparable GAAP financial measures and other associated disclosures are contained in our earnings release and website. Our comments on forward-looking statements and non-GAAP financial measures apply both to the prepared remarks and the Q&A.

With that, I'll hand the call over to Fred.

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Thanks, Tania, for that energetic introduction, and good morning to everyone. In line with our expectations, Grace started the year strong with growth in sales, earnings and EPS while delivering good cash flow. Our momentum from the last quarter continues with overall revenue growth of 10% over last year and EPS growth of 11%.

Catalysts grew 13% and earnings were up 4%. In our Materials business, we also had double-digit revenue growth, excluding our divestitures last year. Segment earnings rose 20%. Our ART joint venture with Chevron posted a solid quarter, essentially flat with a strong prior year quarter. We are benefiting from good demand growth across many of our businesses as we continue to demonstrate the value of our technology and service to our customers. Growth in emerging regions, especially Asia, is shifting our product and geographic mix, and we see a number of positive trends. These trends include continued volume growth in Refining Technologies for the full year, including MTO; strong demand across our polyolefin catalyst portfolio; promising activity in our licensing business; our ART hydroprocessing business remains strong; solid demand in silica; and our productivity and cost improvement initiatives remain on track. Partially offsetting these positive trends is the extended outage of one of our Middle East customers, now forecasted to extend through 2017.

We have modestly tightened the top end of our outlook to reflect this development. We still expect annual EPS growth of 6% to 11% on sales growth of 3% to 4% and no change in our original cash flow guidance. Overall, it's nice to see our commercial and product development efforts paying off with revenue growth across the businesses. I have confidence that we are on pace for another year of earnings and cash flow growth that enable us to invest in our future and return cash to shareholders.

With that, I'm going to turn the call over to Hudson.

Hudson La Force - *W. R. Grace & Co. - President and COO*

Thank you, Fred. We've had some good technology wins this year, which are starting to support better top line growth for us. I get excited when our customers select Grace technologies to deliver value in their products and operations.

In FCC catalyst, sales volumes were up 5% year-over-year and average price was up more than 1%. We saw good volume growth in FCC and MTO catalysts. As Fred said, we expect one of our larger Middle East customers to be down through 2017. We are working very closely with them to speed their return to normal operations, but we have adjusted our full year outlook to assume no catalyst sales to them through year-end.

Since our February call with you, we have confirmed that our business interruption insurance will partially cover the lost earnings from this customer. It is too early to know the exact amount and timing of the insurance coverage, so we have considered a range of outcomes in our updated outlook.

From a market perspective, global gasoline demand was up 0.7% in Q1, with miles driven in the U.S. up 1.6% over last year. Many refiners increased crude runs in March to capture the margin opportunities they have. We expect U.S. gasoline cracks to decline slightly but remain healthy through 2017.

ART had another good quarter with solid margins and has strong visibility into its full year demand. In our MTO business, we recently signed an important new customer and are working to close a couple more. We're developing our second-generation MTO catalysts, which are designed to deliver significantly more value to our customers. We are optimistic about this growth opportunity.

Our Specialty Catalysts business grew in North America and EMEA as expected, and achieved strong growth in China and the rest of Asia. Overall growth in this business was 28%, including over 8% organic growth. We continue to see strong demand for our high-performance CONSISTA non-phthalate polypropylene catalysts. We also continue to see high activity levels in polypropylene process licensing. In Q1, we completed the highest number of proposals since acquiring the business in 2013. In addition, we saw chemical catalysts sales in China pick up this quarter. These businesses remain down from last year, but are starting to show improved performance.

Our Materials Technologies business also grew in Q1, led by good growth in Asia and the beginnings of a recovery in process adsorbents. North America and Europe performed as expected, and Latin America improved. In Asia, we're seeing very good demand in coatings and low distributor inventories. We expect demand to remain strong throughout the year. In Europe, we're seeing good demand in emission control, driven by new technologies and regulatory standards.

In process adsorbents, we're seeing increased bid opportunities in oil and gas and improved win rates, both of which are contributing to a recovery in this business. In pharmaceutical, we see good demand for our silica products, but have seen a shift in orders to 2018 in our pharma fine chemicals business.

As we announced this morning, Sandra Wisniewski is joining our team as President of Materials Technologies. I'm excited to welcome Sandra to Grace. She has a strong record of success growing the businesses she has run and solid experience in the technically sophisticated industries that are at the center of our growth opportunities in Materials Technologies.

Let's look at capital investment and operations, then I'll turn the call to Tom.

Capital investment is core to our future growth and productivity. We actively manage the timing of our growth projects to ensure they are well aligned with demand growth and the timing of customer investments. We continue to move forward with the investments in our fast-growing, single-site polyethylene catalyst segment, and with the FCC catalyst plant in Abu Dhabi, this supports strong growth in the Middle East and Asia. We also have a robust pipeline of productivity investments that help us reduce costs and run our plants at high levels of performance. Our materials usage programs are performing better than expected, and our volume productivity projects are on track.

Some of these productivity benefits may be offset by higher manufacturing and logistics costs we may incur to fully supply the strong demand we have in Specialty Catalysts and Materials Technologies.

With that, I will turn the call over to Tom.

Thomas Blaser - *W. R. Grace & Co. - CFO and SVP*

Thank you, Hudson, and good morning, everyone. Grace's first quarter sales were $398 million, up 10% on good volume growth versus Q1 last year as reported. Adjusted EBIT for the quarter was $87 million, up 5%.

Operating margin was 22%, down 100 basis points over last year, primarily due to lower gross margins. Adjusted EPS for the quarter was $0.68 per diluted share, up 11% from last year. Adjusted free cash flow was $50 million, which compares to $79 million a year ago. Our adjusted EBIT return on invested capital on a trailing 4-quarter basis was 24% as reported, flat with last quarter.

Looking at our business segments. Catalysts Technologies sales were up 13% versus last year on volume growth, including the effect of the polyolefin acquisition and improving MTO catalyst sales. Regional mix shifted in the quarter with North America volume down 6% and the other regions up double digits, including strong growth in Asia of 47%.

Adjusted gross margin was down 420 basis points due to higher manufacturing costs and logistics and regional and product mix, including the effect of the polyolefin catalyst acquisition. Adjusted EBIT grew 4% in the quarter versus last year. In Materials Technologies, sales were up 10%, excluding the exited product lines, and 2% on a reported basis. Asia Pacific grew double digits with China up 40%, as last year's inventory correction did not repeat.

Gross margins were down 30 basis points, primarily due to regional mix. Adjusted EBIT grew over 20% on volume growth and lower expenses. During the first quarter, we saw inflation at expected levels. However, over the rest of the year, we see greater-than-expected inflation, primarily in natural gas, caustic and rare earth. Our corporate costs were up about $3 million, primarily due to a favorable settlement of a claim in 2016.

In the first quarter, we spent $10 million on share repurchase at an average share price of approximately $70. Today, we announced our quarterly dividend equal to $0.21 per share with payment expected on June 8.

Let's review our 2017 outlook, and then we can open the call for your questions. As we said, we're tightening the top end of our full year outlook and continue to expect healthy growth in sales, earnings, EPS and cash flow. For 2017, we expect adjusted EBIT to be in the range of $415 million to $430 million on sales growth of 3% to 4%, adjusted EBITDA to be in the range of $525 million to $540 million and adjusted EPS in the range of $3.30 to $3.45.

We are maintaining our full year guidance on adjusted free cash flow in the range of $265 million to $275 million and capital expenditures in the range of $150 million to $160 million. In Q2, we expect our sales growth to continue, although at a lower rate than Q1. Year-over-year EBIT growth is expected to be similar to Q1 and EBIT margins essentially flat with Q2 last year. We expect cash flow of $130 million to $140 million through the first half.

In closing, we remain committed to our disciplined approach to growth, profit improvement, cash generation and capital allocation management as we deliver increasing value to our shareholders.

With that, I will turn the call back over to Fred for some wrap-up comments.

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Yes, thanks, Tom. I wanted to make sure that -- we've got a lot of moving parts -- that we're all on the same page as we think about the full year. And so I wanted really to summarize it.

We've got -- so if you think of our full year, we have no Takreer catalyst sales for 2017 factored in. We also factored in the strong SC demand we're seeing continuing throughout the year. We've also incorporated higher inflation assumptions into the back end of the year based on where we are today. We have adjusted down our materials for the pharma delay that we're expecting or potentially seeing in -- going into '18, as Hudson mentioned. And we modeled in a range of insurance outcomes on the insurance side. So it's very early. So again, that's what is reflected in our recent guidance and so on. So I want to make sure you are clear on what is in and what is expected.

With that, let's, operator, open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Christopher Parkinson with Credit Suisse.

Christopher Parkinson - *Credit Suisse AG, Research Division - Director of Equity Research*

You hit on this a little on your prepared remarks. But can you just add a little more color on the gross margin, on degradation in the Catalyst segment? You mentioned a few items, including dilution from the PO acquisition from BASF. But I think many of us thought that would be kind of a smaller hit on margins. So can you just parse out the other moving pieces here?

Thomas Blaser - *W. R. Grace & Co. - CFO and SVP*

Sure, Chris, it's Tom. When we built our plan for the year, about 2/3 of the margin decline you're seeing in the first quarter was built into our plan. And 1/3 of it was unexpected, but also nonrecurring. And those 2 areas are really in the area of higher manufacturing costs and higher logistics costs as we serve our Asian and Latin American markets.

Christopher Parkinson - *Credit Suisse AG, Research Division - Director of Equity Research*

That's helpful. And then just very quickly, can you just talk about the sequential price and volume trends you are seeing across your catalyst portfolio, particularly in FCC? Are you continuing to see the benefits of the newer national accounts program and value-add pricing strategy? Just any update here would be -- also be appreciated.

Hudson La Force - *W. R. Grace & Co. - President and COO*

You bet. This is Hudson. Yes, we are seeing sequential progress. We're seeing -- this is the, gosh, fourth or fifth quarter in a row where we've seen sequential progress in pricing, and now for 2 quarters, year-over-year improvements as well. We have programs in every region and every business to continue to make sure that we're capturing the full value for the technologies we're giving our customers.

Operator

And our next question comes from the line of Robert Koort with Goldman Sachs.

Christopher Evans - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Chris Evans on for Bob. I appreciated your summary of the moving pieces at the end there. Maybe just to make sure I understand fully. I thought previously you suggested that the Takreer outages represented the bulk of the variance in your full year EPS range. So should we look favorably at the $0.10 cut at the top end? Is there some upside from something else that's keeping you off the bottom of your range? Or am I missing something?

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

No, I think you're thinking about it similar to how we're thinking about it. We had a very -- we have a very good strong demand in our Specialty Catalysts business. Organically, it was up 8%. We're also being realistic and factoring in some higher inflation expectations in some of the pharma side. So yes, yes, I think you're characterizing it correctly.

Christopher Evans - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Great. And then you cited the 5% FCC volumes in the quarter. Just to be clear, was there any contribution? It doesn't sound like there was from Takreer. And is there any expectation that, that kind of growth can continue throughout '17?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Chris, this is Hudson. We had a little bit of sales to Takreer in the first week or 2 of the quarter, but there were no significant catalyst sales to them in Q1. And as we look through the rest of the year, as I commented, we've seen some good technology wins in FCC and in other businesses. We like where we are right now with our customers. In Q -- in the second half, we will start to compare to the second half of last year when we did have Takreer sales, so that will be a tougher compare. But in terms of where we are with other customers, we feel pretty good right now.

Operator

And our next question comes from the line of Mike Harrison with Seaport Global.

Jacob Schowalter - *Seaport Global Securities LLC, Research Division - Associate Analyst*

This is Jacob Schowalter on for Mike. It sounded like the pipeline for polyolefin catalyst licensing remained pretty strong in the first quarter. Do you still expect that to contribute as early as Q4, or maybe even little in Q3? Or how do you think about that?

Hudson La Force - *W. R. Grace & Co. - President and COO*

It's definitely a possibility. I wouldn't go so early as Q3. But we have some customers that want to fast track their investments, and we're doing everything we can. It's possible that some of that would show up in Q4. But the bulk of it will be in '18 and '19.

Jacob Schowalter - *Seaport Global Securities LLC, Research Division - Associate Analyst*

Okay. And then in materials with the volume strength, could you maybe talk a little bit about -- are some new products gaining traction? And if so, which ones?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Most of this is in Asia with customers in coatings. And there is some new technology and some adoption of technology that has been used in other regions. And that's the biggest single thing that we're seeing. But when I look across the globe in that business, we're seeing good interest in pharmaceutical end uses. We're seeing good interest in environmental catalysts end uses. And we're seeing a pretty good recovery in process adsorbents. That's mostly driven by oil and gas investments.

Operator

And our next question comes from the line of Ben Kallo with Robert Baird.

Benjamin Kallo - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

First of all, on Takreer, could you just walk us through pulling it out for the full year, what your visibility, like, is there? And if there is any kind of workaround where would you see anything come online earlier? And then my second question is on Material Technologies. It looks like the operating margin was pretty strong. So how do we think about that operating margin as this volume -- if we have this type of volume growth and where that can go?

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Ben, this is Fred. I'll the first part and then I'll turn Materials over to Hudson. We're working with Takreer every week. And we and them, together, are looking at other options to run that unit in, as you called it, workaround mode. And I think the decision won't be made in that probably until -- over the -- probably in the next couple of months. And really the factors are do you do a workaround and then delay the full startup, or do you just get at it and do the completion and get the -- all the units in the downstream up. So I think that is what's being wrestled with at this point in time. But we've got good visibility on that side of it, and we wanted to be -- we want to reflect it all out in our latest guidance. So I'll turn over the Materials side to Hudson.

Hudson La Force - *W. R. Grace & Co. - President and COO*

You bet, Ben. On the gross margins for Materials Technologies, our margins in Q1 were 39 points and change. We'll probably wiggle around that number a little bit, Ben. But I think that's a good healthy gross margin level for that business. We do play in some pretty high end -- high-value end-use applications. But we also don't want to get our margins out of line in a way that would constrain our growth in that business.

Benjamin Kallo - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And then on the operating margin side, there was -- the focus was the year-over-year increase there. Could you just talk about that and where that can go?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Sure. I -- what drove -- what's driving the year-over-year increase, there's a couple of things. It's the exit of the lab, what we call the lab products businesses over the course of last year. Those had good gross margins, but were breakeven at best. And so you're seeing a year-over-year improvement from that. The other thing that we are seeing is better operating leverage. And our plants are running hard and running well. And that gives us some operating leverage on the bottom line. But I'd make the same point. I don't want to do something that would arrest the growth that we're seeing in that business.

Operator

And our next question comes from the line of Laurence Alexander with Jefferies.

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

I guess, 2 questions. First, can you -- if you look at the headwinds you flagged that are -- mostly appear to be items that are moving into 2018, that is the insurance issues settling out, the pharma delay getting sorted out in Materials, and Takreer. If you bundle that all together, how much of a year-over-year tailwind would you have? And then, secondly, as you think about 2018 to 2020, last time you had a rare earth inflation call-out, if memory serves, you clipped about $30 million of EBITDA on the inflation wave. How do you see the inflation prospects at this point? I mean, how tight is that supply chain getting?

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Yes, let me -- this is Fred. Let me start with the inflation side. We are starting to pick it up. It's -- as Tom mentioned or somebody mentioned, it's really been in caustic as well as natural gas. It hasn't hit the rare earth side yet. But, again, if we see a dramatic pick-up as well as a -- some constrain in some of the demand -- or some of the supply base around our material, we'll look again at the potential of surcharges on that side of it. So I don't think we're -- well, I know we are not at that point now, but as we look at that. The Takreer piece will be a tailwind for us when it comes back. I think it'll be a tailwind similar to what you saw in the second -- you could factor it in based on the second half of last year. Predominantly, it was in the fourth quarter and about half of it in the third quarter. And that will continue for us.

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

And then can you characterize a little bit the MTO opportunity, like if you think out 3 to 5 years, how much that market can grow for you?

Hudson La Force - *W. R. Grace & Co. - President and COO*

It's -- Laurence, this is Hudson. The -- so there is a significant installed base of operating MTO units in China. And that's really the market that we're focused on right now. And we started to focus on that business, oh gosh, 12 or 18 months ago now, I think, with a focused technical and commercial effort. And we're starting to see those results. And the total market opportunity is -- it's well over $100 million...

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

I mean, (inaudible)

Hudson La Force - *W. R. Grace & Co. - President and COO*

Just on the installed base, and we want our fair share of that.

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

Okay. And then, finally, if you don't mind one last one. It's the marine fuel regulations at the end of the decade. Can you characterize how that would affect your business? I mean, if there's a new order cycle, does it favor some of your existing products? What's the mix effect there?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Yes, good question, Laurence. So this is a significant demand positive for the ART hydroprocessing business. That's where we'll see it. We are seeing customers react to that change in the regulatory timing. And we would expect it to really firm up demand in our ART hydroprocessing business.

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

And is that like an after 2020? Or is that -- does that show up earlier because they have to retrofit earlier?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Yes, no, you're right. The regulations come into effect in 2020. But the investments will have to come faster.

Operator

And our next question comes from the line of Chris Kapsch with Aegis Capital.

Christopher Kapsch - *Aegis Capital Corporation, Research Division - Research Analyst*

Quick one on this business interruption and insurance recovery. Just how would that play out? Because it strikes me as something that you might not be able to quantify until we know that Takreer is back online. So just wondering when you can recognize that benefit. Would it be a discrete onetime? Or will it be layered in, in the remaining quarters of the year? I assume there was no recovery booked in 1Q numbers.

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Yes, the way the insurance works, we validated this month that it is a valid claim, that we have a valid claim. We still need to work through a number of the nuances. What's the deductible on that? What's the total amount of the claim? I think we know that side of it as well as how we're going to calculate it. And I -- as we get into that side of it, there could be some cash and earnings benefit from that being booked into 2017. And we modeled in some ranges on that, that side of it. Now I'll tell you the flip side of that is there is this whole mitigation. We have a duty to mitigate those costs. So anything we sell that may mitigate it, any cost we reduce and so on. So it's a tough one. We will give you -- I think by the end of the second quarter, we'll be able to quantify it a little better, and we should have a good basis for it, what we see at the end of second quarter.

Christopher Kapsch - *Aegis Capital Corporation, Research Division - Research Analyst*

Okay. And would it be a discrete quantification that just flows through 1 quarter? Or would it be kind of tacked on each quarter until Takreer is back up and running?

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Yes, anticipated to be tacked on each quarter, but that's still -- I think that's the way it's going to play out given the discussions we've had.

Christopher Kapsch - *Aegis Capital Corporation, Research Division - Research Analyst*

Okay. And then I had a follow-up just on the catalyst segment gross margins. A couple new ways of looking at things with new assumptions, no Takreer for -- throughout '17, stronger-than-expected SC volumes. The FCC pricing continues to gain traction. And then presumably without Takreer, there is some -- maybe some manufacturing absorption variance headwinds. So as far as gross margin looking forward for the balance of '17, as contemplated in your guidance, can you just kind of parse out what are the moving parts there in terms of how we should be thinking about that and those margin drivers? And also is there any updates on any efforts to place what extra catalyst capacity volume that you may have, perhaps, for other independent refiners or other opportunities to sell a little extra catalyst?

Thomas Blaser - *W. R. Grace & Co. - CFO and SVP*

Chris, thanks. This is Tom. I'm going to take the first piece, and Hudson will take the second piece, if that's okay? Let me give you a little color around the margin outlook. I see -- when I look out over the remainder of year, I see sequentially improving margins quarter-to-quarter. And that reflects, over time, the lapping of the anniversary of the polyolefins business, the avoidance of the manufacturing hiccups we saw that I referred to earlier in the first quarter, and the completion of a once-every-5-year turnaround of our Worms plant in May. And we'll start to see continued improvement through the rest of the year. As we've mentioned in our guidance, we're bringing the range down from 42% to 43%, down to 41% to 42%. However, I think one thing you got to keep your eye on is that we do expect to leverage our operating expenses on these higher sales, and through that, deliver an EBIT margin that's at or better than last year. Hudson?

Hudson La Force - *W. R. Grace & Co. - President and COO*

As Fred mentioned, we do have a duty to mitigate the lost sales from the Takreer outage, but that doesn't mean we're going to change the way we're running our business. And for the last several years now, we've been running this business to maximize our focus on technologies, selling value to our customers, making sure we're being paid for the value that we are bringing to our customers. And that's not going to change.

Christopher Kapsch - *Aegis Capital Corporation, Research Division - Research Analyst*

Does -- one last one. Does the absence of Takreer materially affect the optics of the pricing variances that we'll be looking at for the catalyst segment?

Hudson La Force - *W. R. Grace & Co. - President and COO*

I'd say not in a material way, Chris.

Operator

And our next question comes from the line of Edlain Rodriguez with UBS.

Edlain Rodriguez - *UBS Investment Bank, Research Division - Director and Equity Research Associate, Chemicals*

Just one quick question on Materials Tech. The nice increase in volumes that we've seen, like, what's driving that? And is that sustainable? Is it mostly just because of the inventory we had last year? Or like what is really driving the growth we're seeing there?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Edlain, this is Hudson. In Q1, roughly half of the year-over-year increase was because we were comparing to the weak Asia results in Q1 of last year. But that aside, there was still good growth in that business in Q1. And I think, as we look sequentially, we'll continue to maintain that level of performance. When you look at the silica side of the business, we'll see good year-over-year growth throughout the 4 quarters of this year, although, again, not as strong as we saw in Q1 because of the inventory correction last year. On the fine chemicals side of the business, we will see good growth. We saw good growth in Q1. That starts to level out in Q2. And then in the second half, where we have volumes pushing into 2018, we'll have a pretty tough compare against a strong second half that fine chemicals had last year.

Operator

And our next question comes from the line of Jim Barrett with CL King & Associates.

James Barrett - *CL King & Associates, Inc., Research Division - MD*

Fred, question for you. The hiring of Sandra Wisniewski as the President of Material Technologies, how important was it for that division to have someone who was specifically from the pharmaceutical industry to fill that role?

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Yes, it was a key consideration in the hire. We've been -- as you know, if you look at the margins in the silica business over the last 10 years, they are up almost 10 full points. And as we've been shifting this from more commodity based to higher end, which have the pharma, have the -- that side of it. So that was a key consideration. We're also seeing a lot of acquisition opportunities or potential opportunities around that space where -- and we needed somebody that really knows it. And I think Hudson did a great job recruiting her here. So...

James Barrett - *CL King & Associates, Inc., Research Division - MD*

And then, secondly, how close is the company, given the increase in caustic and natural gas, to considering additional selected price increases in the second half?

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Jim, I'll tell you when we do it. And I'm not trying to be coy, but again, that's something we want to consider and work with our customers on, obviously.

Hudson La Force - *W. R. Grace & Co. - President and COO*

I will make one distinction, if I may. We have pricing initiatives in place that go back to last year in the catalysts business and Q1 in the Materials Technologies business. The point that Fred is touching on is whether a surcharge is appropriate, and we're not at that level in rare earth at all. It's possible that something could happen with surcharges on caustic, but it's too early at this point.

Operator

Our next question comes from the line of Chris Shaw with Monness, Crespi, Hardt & Co.

Christopher Shaw - *Monness, Crespi, Hardt & Co., Inc., Research Division - Research Analyst*

I think you alluded to it in answer to Chris' question. But on the BASF polyolefin catalyst business, the margins there, is there a plan? I mean, can they -- you get those margins back up to sort of segment level? Or are they -- is that a sort of business that's always going to be a lower margin than the rest of that segment?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Chris, this is Hudson. That was always the plan from the date of the acquisition. The main driver on the lower margins is capacity utilization in the plants. And as we bring up the utilization of those plants, those products will come back up to company -- to margins that are more in line with the company. That's going to happen over the course of the next 18 months or so. So it will be late '18 before we get those plants at the utilization we want.

Christopher Shaw - *Monness, Crespi, Hardt & Co., Inc., Research Division - Research Analyst*

Is that timeline based on orders you already have, kind of, or that you can get? Or how is that -- where do you [get the concept]?

Hudson La Force - *W. R. Grace & Co. - President and COO*

It's based on the demand forecast. Some of it is -- most of it is business that's in hand today. But the bigger piece that drives the timeline is investments that we're making to reoptimize where we are manufacturing products across the network. We have plants that are oversold right now. We have plants that are underutilized, and we're spending some money to optimize all that.

Christopher Shaw - *Monness, Crespi, Hardt & Co., Inc., Research Division - Research Analyst*

All right. I get that. Then on the Materials Technologies, the shift in this -- the pharma business into 2018. I don't completely understand what goes on in, I guess, that piece of the business. But is this specifically a couple of customers that are just telling you they're going to come up with a new product later? Or is it an industry shift of some sort?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Chris, these are fine chemicals that are sold to pharmaceutical customers that -- think of them as pharmaceutical ingredients that are incorporated into final dosage-form products. And their timelines, in the particular cases that we're talking about, our customers' timelines have shifted based on the progress that they're making with regulatory reviews and things like that. And so our timeline shifts accordingly. It's not a bigger industry thing. It's specific to specific programs.

Operator

And our next question comes from the line of Bobby Geornas with Susquehanna.

Bobby Geornas - *Susquehanna Financial Group, LLLP, Research Division - Associate*

Just a quick question on Catalysts Technologies. Pricing was up about 0.8%. Could you just give us a little bit of clarification in terms of whether it was both refining and polymer in the chemical catalyst side? Or was it mostly on the refining side that you saw that pricing gain?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Refining was up more than 1%. So that was the real driver for it.

Bobby Geornas - *Susquehanna Financial Group, LLLP, Research Division - Associate*

Okay. And was the other side of the business up, flat or down?

Hudson La Force - *W. R. Grace & Co. - President and COO*

It was down a little bit on mix. But it's a mix thing, not a price reduction thing.

Bobby Geornas - *Susquehanna Financial Group, LLLP, Research Division - Associate*

Okay. And just one additional question on surcharges. I know it's still early, but are there -- is there some meaningful percentage of customers for whom perhaps you couldn't pass along those surcharges to? And in the event that you do, are there caps or delays? Is there like a lag effect there in terms of passing those along?

Hudson La Force - *W. R. Grace & Co. - President and COO*

It's really too early. We don't even -- we are not even at the point of framing up a surcharge. So it's just too early.

Operator

And our next question comes from the line of Curt Siegmeyer with KeyBanc Capital.

Curtis Siegmeyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

Could you comment on any changes you've seen in utilization rates in the catalyst business? And how much that might be behind some of the better pricing that you've seen on that side of the business?

Hudson La Force - *W. R. Grace & Co. - President and COO*

Our utilization rates have been strong, although I wouldn't connect it directly to the pricing initiatives. Those are really being driven by introducing new technology, new and better technology to our customers. It's -- that's really the fundamental driver.

Curtis Siegmeyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

Okay. And then, could you maybe give a little more color, I know you touched on it a little bit, on the strong growth that you had in the Specialty Catalysts side? How much of that is from China versus developed markets and any other color you can provide there?

Hudson La Force - *W. R. Grace & Co. - President and COO*

It's -- the bigger single piece of this is our CONSISTA non-phthalate polypropylene catalysts. And this business is -- or this product line has been growing really nicely for, gosh, I don't think it's 2 full years now, but 18 months probably. And we continue to build momentum. It's global. We see it here in North America. We see it in the Middle East. We do see it in Asia as well. And it's a compelling technology for our customers.

Fred Festa - *W. R. Grace & Co. - Chairman and CEO*

Yes, I would add one comment to it. It allows our customers to differentiate their polypropylene end-use product. And that's why the adoption has been very strong.

Operator

Our next question comes from the line of Robert Koort with Goldman Sachs.

Christopher Evans - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Chris, again. So Takreer has been the headline FCC unit for what seems like forever, but you gave an update on the pipeline elsewhere, outside of FCC. But is there a pipeline of new FCC units coming out there? And steel going in the ground that we should be aware of? Or maybe some new plants that you guys could win with your technology that could overtake some sales to Takreer or be a catalyst on the horizon? And then maybe just an update on ART and how that's going. Kind of an in-line quarter with last year, which was quite strong.

Hudson La Force - *W. R. Grace & Co. - President and COO*

Chris, this is Hudson, again. So there -- at any point in time, there are always customers looking at adding refining capacity. And whether it's debottlenecking or adding to an existing refinery or a Greenfield refinery, let's say, in Asia or the Middle East, there's always activity around that. There's nothing as significant as Takreer has been over the last few years. But their customers are looking at long-term demand for transportation fuels and making their capacity investment decisions, and that market still grows. On ART, the -- Laurence asked a few moments ago about the MARPOL regulation. That is putting -- what's the expression, a tailwind behind demand for hydroprocessing catalysts. That demand was strong already. We're seeing good demand in our hydrocracking business, which is where customers have been investing more and more over the last 2 or 3 years. Margins have improved across the ART portfolio. And they had a great year last year, and we expect them to have another solid year this year.

Operator

And at this time, I'm showing no further questions. So with that said, I would like to turn the conference back over to Ms. Tania Almond.

Tania Almond - *W. R. Grace & Co. - Investor Relations Officer*

Great. Thank you. We would like to thank everyone on the call for joining us today. If you have any follow-up questions, you can reach me at (410) 531-4590. Have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a wonderful day.
