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GRA - Q2 2017 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 2Q17 adjusted diluted EPS of $0.84.

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CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

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

John Ezekiel E. Roberts *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

Kevin William McCarthy *Vertical Research Partners, LLC - Partner*

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

Michael Joseph Harrison *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

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

Roger Neil Spitz *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

PRESENTATION

Operator

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

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

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

Thank you, Amanda. Hello, everyone, and thank you for joining us today, July 27, 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 of 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 condition.

We will discuss certain non-GAAP financial measures, which are described in more detail in this morning's earnings release and on our website at grace.com.

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 as well as the Q&A.

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

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

Thank you, and good morning to, everyone, for joining us at this early hour. Overall, I'm pleased with the way we're managing the company. We're generating good cash flow to support our growth plan. We're aligning our supply chains to capitalize on new opportunities, and we're managing the customer outage announced earlier this year.

Grace's strong performance continued through the second quarter, with sales up 10% and adjusted EPS up 14%. Organic sales volumes were up nearly 5% in the quarter. Our Refining Technology group is capturing new FCC business, securing trial volumes that will pay dividends into 2018 and beyond. The [ART] joint venture continues to execute on its high-grading strategy, while capturing new unit builds to secure future growth. I'm also pleased with this group's new product commercialization success, highlighted by the surge in MTO revenue.

Demand across our polyolefin's business is robust, led by polypropylene, and is especially strong for our non-phthalate catalyst. This morning's announcement of a licensed agreement with CKPC for a unit that will be the world's largest single polypropylene train is a great example of our ability to win in the marketplace on the strength of our technology. We have seen the licensing business bounce back. Since the beginning of 2017, our contract backlog is up more than 50%. Materials Technologies continues to be successful in a strong market for silica gel, colloidal and other industrial applications. The delays in fine chemicals and nutraceutical orders is dampening performance in this segment. But the focus on operational excellence and productivity actions around capacity, position the business for long-term growth.

I'll now turn it over to Hudson to provide some more additional details.

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

Thank you, Fred. Let's start with FCC catalysts, where our results reflect good market growth and very good commercial performance for our technologies.

From a market perspective, low crude prices continue to support good demand for gasoline and polypropylene from FCC units. Global gasoline demand grew 1.9% in Q2, with miles driven in the United States, up 1.2%. Global refinery utilization also increased 1.9% over last year.

For our business, FCC catalysts sales were up 10% year-over-year, reflecting significant new accounts and new trials driven by the value and performance of our resid and polypropylene technologies. Although the customer outage has affected our sales and margins this year, our strategy is unchanged. We are focused on delivering value to our customers in the most demanding FCC applications. The more demanding the application, the more value our customers realize from our product and technical capabilities. Importantly, our successes in Q2 set the stage for longer-term growth as well. In the next 3 years, we expect multiple FCC units to start up in Asia, the Middle East and Africa. Some of these units will be large and are being built to produce petrochemical feedstocks similar to the units we began supplying in Q2. We have a solid position in this high-value product segment.

While we work to grow sales, we remain focused on pricing. Average FCC catalyst prices were up slightly in Q2, excluding the effect of new business and bid market sales. We continue to work very closely with our customer, following a fire at their refinery early this year. In our Q1 earnings call, we said that we did not expect any catalyst sales to this customer in 2017. Recent media reports have indicated that the refinery may not be back to normal operations until 2019, when repairs from the fire are expected to be complete. It is possible to run the FCC unit in a modified mode, while the other refinery units are repaired. And we are working closely with our customer to evaluate that option. We expect to have a better view of this in the fourth quarter. While it is possible that we will have some catalyst sales to this customer next year, we have adjusted our business plans to assume no sales in 2018.

ART had another good quarter and enters the second half with strong visibility to Q3 and Q4 demand. Growth this quarter was driven by good ebullating bed sales and new hydrocracking opportunities. We expect ART revenue to be up double digits this year with improved product margins, reflecting the strong demand for our hydroprocessing technologies. As you know, we are adding capacity to supply the continued growth in this business.

MTO sales continue to grow nicely in China, with another customer beginning to trial our MTO catalyst during the quarter. We expect to introduce our second-generation MTO catalyst, before the end of this year.

Let's turn to Specialty Catalysts. Our Specialty Catalyst business grew 26% in Q2, with good demand in almost every region. We continue to see strong demand for our high performance, consistent non-phthalate polypropylene catalysts. And last year's acquisition of the LYNX product lines is tracking ahead of our earnings and synergies expectations. We expect to meet or beat our post synergy EBITDA multiple target of 8.8x.

From a market perspective, demand for plastics continues to grow faster than global GDP, as evidenced by our customers' significant new capacity investments. In polypropylene, 19 million metric tons of capacity is expected to come online in the next 5 years. With China growing at more than 8% annually and North America more than 4% annually during this period. We are well-positioned to capture a significant share of the catalyst requirements of these new plants.

We are also well-positioned to capture new polypropylene process licenses and continue to see high levels of activity in our licensing business. This morning's announcement is a great example. This will be the largest single train PP unit in the world, able to use our technology to produce a full range of resins, from basic homopolymers to more sophisticated random and impact copolymers.

Our licensing pipeline is healthy and growing with more than 10 opportunities expected to reach decision points in the next 6 to 9 months. With our win rates, we're optimistic about opportunities for both licensing and polypropylene catalysts. In polyethylene, over 1.3 million metric tons of new U.S. Gulf Coast capacity is coming online within the next 6 to 12 months. We are working closely with several customers on new catalysts for these units, and expect good growth over the next 2 to 3 years, as these plants reach full utilization. In addition, customers are starting to focus on further polyethylene capacity investments in the 2021 to 2023 timeframe.

For Materials Technologies, sales grew 5% year-to-date, excluding the product lines exited last year. Growth has been strongest in coatings applications in Asia, emissions control applications in Europe and process adsorbents applications in oil and gas.

Solid growth in the silica markets has been offset by much lower sales in our pharma fine chemicals business. After many years of strong growth, we have seen a significant slowdown with several customers experiencing regulatory delays or lower demand for their products. We are rebuilding our pipeline of opportunities, but don't expect sales and earnings growth to resume until next year for this business.

Let's discuss operations, and then I'll turn the call to Tom. As you know, from watching our results over many years, manufacturing productivity has been a significant source of margin expansion for us. This year, we have experienced growing pains in a few of our plants where higher sales growth rates have increased capacity utilization. Higher costs in these plants have offset our productivity gains and impacted our margins. We have taken a number of steps to address these issues and expect to have them resolved before year-end.

Raw material inflation has also added to our costs this year, but we think most of the inflation is now behind us. We expect sequential inflation to slow, though, year-over-year inflation will continue through year-end. Importantly, we completed a major 5-year turnaround at our largest plant in the quarter. The site was completely shutdown for about 3 weeks. The turnaround was completed successfully, on-time, on-budget and with no one hurt.

With that, I'll turn the call over to Tom.

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

Thank you, Hudson. Before we get into the numbers, I'll provide some additional context that I believe will help in understanding our results year-to-date and our guidance for rest of the year. To do that, I want to draw your attention to Page 7 of the business update, where we've provided a gross margin bridge illustrating the main drivers of our year-over-year margin change through the first half.

First, is the net effect of acquisitions and divestitures, which contributed to a 5% favorable comparison on sales year-to-date, but were a 110 basis points drag on margins, each of which, was in the range we expected. We lapped the effect of these transactions by the end of Q2.

Second, the advent of the customer outage and the new business capture, mentioned by Fred and Hudson earlier, contributed 140 basis points to our gross margin decline year-to-date. This new business not only generates cash flow, but it'll also sets us up for future margin expansion in 2018 and beyond. As an offset to this effect, we've recognized $13 million of insurance recoveries year-to-date, and expect to reach our $25 million policy maximum during 2017. These recoveries are not included in gross margin and do not fully offset the absence of this business and the additional costs of pivoting our FCC supply chain. Year-to-date gross margins, including these recoveries would have been 160 basis points higher than as reported.

Third, as Hudson mentioned, we're experiencing higher input and operating costs. Year-to-date, these higher costs have had 160 basis point impact on gross margins. We believe inflation is beginning to ebb and we are confident in our ability to address the growing pains in our operating performance, which contribute to increasing margins on a sequential basis for the rest of the year.

Now let's turn to the quarter results. Grace's second quarter sales were $430 million, up 10% on strong volume growth versus Q2 last year. Adjusted EPS for the quarter was $0.84 per diluted share, up 14% from last year. Adjusted free cash flow for the first half was $136 million, which compares to $132 million a year ago and represents approximately 50% of our full year expectations. Adjusted EBIT for the quarter was $104 million, up 8%, including $10.6 million of insurance recoveries. Operating margins, 24%, down 40 basis points over last year due to lower gross margins and partly offset by the insurance recoveries and higher ART JV earnings. Our adjusted EBIT return on invested capital on a trailing 4-quarter basis, was 24.6%, up 30 basis points from the start of the year.

Looking at our business segment. Catalysts Technologies sales were up 15% versus last year on volume growth, including the effect of the polyolefin catalyst acquisition and our fast-growing MTO catalyst business. Regional mix continues the shift we saw in Q1 with North America volume down 2% and other regions up, including strong growth in Asia and Latin America of 57% and 29%, respectively.

Adjusted gross margin of 40.4% as reported, was down 580 basis points due to regional product mix and higher input and manufacturing costs. This mix effects were mostly driven by the rebalancing of our FCC sales in the wake of the continuing customer outage and the effect of the polyolefin catalyst acquisition.

Adjusted EBIT grew 16% in the quarter versus last year, including the benefits of improved ART JV earnings and the insurance recoveries. Sequentially, catalyst technology sales grew 9% with 120 basis points improvement in gross margin.

Turning to Materials Technologies. Sales were up 1%, excluding the exited product lines and down 3% versus last year on a reported basis. 4% growth in our silica's business was more than offset by lower sales in pharma fine chemicals. Sequentially, Materials Technologies sales grew 5%. Gross margins were down 320 basis points and adjusted EBIT was down 14%, primarily due to product mix with higher silicas and lower pharma fine chemicals regional mix and higher manufacturing costs. In the second quarter, we spent $20 million on share repurchases at an average per share price of approximately $71. Today, we announced our quarterly dividend equal to $0.21 per share with payments expected on September 7.

Now let's pivot to our 2017 outlook. We are maintaining our full year guidance. More specifically, we expect sales on a constant-currency basis to be at the high-end of the range. EPS to be closer to the middle of the range, and EBIT and EBITDA to be in the lower half of their respective ranges. Adjusted free cash flow is expected between $265 million and $275 million, including capital expenditures of $150 million to $160 million.

Our outlook assumes an average euro exchange rate for the year of $1.11 compared to $1.10 last year. For the third quarter, we expect total sales growth to be in the low- to mid-single digits over last year, as we have lapped the polyolefin acquisition and the Middle East customer start up. We expect EPS to increase by more than 10%, including the effect of improving gross profit, continuing insurance recoveries and lower effective tax rates.

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

With that, I'll turn it back to Fred for closing remarks.

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

Thanks, Tom. As we enter the second half of the year and prepare for 2018, our businesses are well-positioned to continue to capture the growth we see in our markets. We've taken our first look at 2018, including the extended customer outage and no insurance recoveries. As we stand today, I am confident we can achieve a minimum, minimum, 7% earnings per share growth, continue to generate high cash flow to fund our growth, increase our dividend and continue our share repurchase program. Obviously, we'll work to improve our position in the upcoming months. Just as important, we're still on track with the 5-year framework we presented in May.

With that, I'll open the call up for questions. Tania?

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

Go ahead, operator.

QUESTIONS AND ANSWERS

Operator

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

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

So let's get off [Takreer] for a second and refocus on the core business. Just given some of your comments on refining utilization, the new business acquisition in 1Q, high bid market sales, et cetera. What do you think are going to be that the true key drivers for catalyst tech in 2018 in terms of both growth and margin? And while I'm sure FCC should probably be the focus here, can you also touch on HPC and ART? And then also anything in spec cats worth noting?

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

Go ahead, Hudson.

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

It's a great question, Chris. This is Hudson. So when you think about the big drivers, I'll break it into what drives growth for FCC, for ART, our HPC business and for Specialty Catalysts. For FCC, it really boils down to 2 things. One, is the demand for transportation fuels, which has remained strong with low crude prices; and the second, is the demand for propylene coming from FCC units as a chemical feedstock. The world is short on propylene and more and more of our customers are investing to produce propylene or tuning their FCC units to produce propylene. That's a great opportunity for us. The basic strategy of buying resid type fuel -- type crude and converting that into propylene is a high -- it's a hard -- it's a complex demanding application in the FCC unit and our catalyst play very well there, and make a big difference for our customers. The other thing that's growing -- that's a growth driver for FCC catalyst business, our MTO catalysts in China. And we've over the last year or 2, established a nice position there. We're still penetrating that market and expect to see continued growth into 2018 and beyond. For the hydroprocessing catalysts, it's really -- demand is really being driven by 2 things. One, is tighter regulatory frameworks around fuel quality; and the second is, the world's shifting towards more harder to process crudes. Both of those create investment opportunities for our customers around resid processing units, hydrocracking units and that's driving demand for hydroprocessing catalysts. That demand is up significantly this year, and we expect it to continue to grow over the next 2 or 3 years. And then the third piece, polyolefin catalyst, what we call our Specialty Catalysts business, it's ultimately driven by the demand for plastics. And with the position that we've established, both the process licensing position and also the polyethylene and polypropylene catalyst position, we're participating very nicely in the growth in that market. And I think we're growing -- not I think, I know we're growing faster than the market. Again, partly because of the combination of licensing and catalysts that we have and the value of our high-performing polypropylene catalysts.

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

Chris, let me stop there and check to see if that gave you the color you wanted.

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

That did, but it just led into the follow-up I was going to have. Just -- well, our expectations or the Street expectations really been for a bit of a lull for licensee deals. But you've had some pretty solid announcements in the past few quarters and pretty good one this [AM]. Can just kind of -- just update us on your thoughts on the cadence throughout the balance of 2017 and 2018. And then also, any implications on the margins as well over, let's say, the intermediate to long-term?

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

Sure. Now a great question again. So we -- I don't mind saying, we've been a little surprised too at how fast licensing has come back. Six or 9 months ago, we were prepared for a couple of years of kind of trough licensing activity. And what we saw at the end of last year was a real increase in the number of inquiries. Six-months later, those processes have matured, we're starting to see customers make decisions. We expect additional decisions in the next 6 to 9 months. And the trough was shorter than we thought, which is great. And licensing comes at a very high margin as you understand, and that'll be a margin good guide for us in Specialty Catalysts over the next couple of years.

Operator

And our next question comes from the line of Kevin McCarthy of Vertical Research Partners.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

On Slide 7, as it relates to FCC, I think you mentioned some new business acquisition costs. Would you discuss the nature of those whether or not it's related to your insurance recovery efforts or separate from that? And maybe elaborate a little bit on the income statement impact there?

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

Sure, Kevin. This is Hudson, again. These are not directly related to insurance in anyway. But they are related to our response to the customer outage. And one of the things that we had to deal with in Q2 was, what was the duration of that outage? And it had been uncertainty for us. We wanted to make sure that we had a strong business base for this year and for 2018 regardless of how the outage -- what the timeline turned out to be on the outage. And so we did spend some money, establishing some new customers. These -- you should think of these as sort of one-time costs associated with setting up our business with a couple of new customers.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Okay. That's helpful. And then I guess a broader question. As I look across the chemicals industry, we've seen a lot of verticals within that consolidate, coatings, agriculture to name a few. Activity in catalysts has been relatively modest. You've had the polyolefin catalyst deal yourself last year. As you look out 3-plus years, do you see meaningful opportunity for consolidation in the industry? Or rather is it the case that the technology is so specific that the industry does not lend itself to meaningful consolidation?

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

Hey Kevin, it's Fred. Now what -- I think there will be consolidation, but in a little different framework than you pointed out. I think the consolidation will come between catalyst producers and licensors. There is a strong undertow both from our customers and as well as the industry out there to supply a full range package. And that package includes technology from a licensing, engineering side as well as the catalyst solution. And where we combine these, we've seen it. What we have done on the ART joint venture with the alignment with CLG on that side, it's paid huge dividends. We've seen it, when we acquired the UNIPOL licensing business from Dow and then combined it with our catalyst side and so on. And as these customer -- as our customers continue to change their technology, they're looking at it from both standpoints. And, I mean, we're involved in a situation right now, as you know, in the Middle East, with that down, and we partnered directly with the technology provider of that unit. And as we look at this and how do we modify the catalyst? How do they modify the FCC unit to get the best performance? So that's the combination that will happen further as we go down the line.

Operator

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

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

This is Chris Evans on for Bob. I was wondering if we could talk a little bit about the insurance coverage around Takreer. Sounds like you're getting about $27 million, which will run out at the end of this year. And then expecting no volumes from Takreer in '18. So I guess the question sort of top level is, do you expect when you go into '18 that other opportunities around FCC can make up that $27 million insurance payment?

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

Yes. Yes. I mean, what we've said, and I wanted to put a marker out there because that's -- this is on everybody's mind. The insurance recovery is about -- is -- the max we get is $25 million based on everything we see right now. We will go through that in 2017. We also wanted to take a -- given the past, we wanted to be, I won't call it conservative, but realistic on when this unit will really start up. So we've taken all that volume out. Given everything that we have today, and I feel good about the positioning of our businesses. I feel good about what -- where we are on FCC, especially good on the Specialty Catalysts side of it. I wanted to give you a framework where I think we are at -- right at this point. Now, obviously, we've got some good momentum, and we're going to continue to work that over the next, listen, we got 18 months until 2018 runs out. So I mean that's really the high point of it, as we work through it.

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

Got you. And then in this year, I believe your prior guidance around ART was actually maybe for -- I think when the year started was for it to be flat year-over-year, if your comping on a pretty good performance in '16. It looks like you're really crushing the first half numbers from last year. So should we expect a different cadence in the second half or a continuation of the real strong results we've seen in the first half?

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

Chris, this is Hudson. I -- we have had good performance in ART. Some of this is timing within the year. This year's timing compared to last year's timing. We do see strong growth in ART. The earnings will be up for the year over last year. And I'll leave it there.

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

Will the second half be up as much as...

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

No. No. That's -- sorry that was -- maybe I was too subtle. That was the point of my timing point. This year's first half was strong relative to last year's first half. This year's second half won't be as strong relative to last year's second half. But on a full year basis, ART will be up year-over-year.

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

Next question operator?

Operator

Our next question is from the line of Ben Kallo of Robert W. Baird.

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

I guess, could you just talk a little bit about the 7% EPS growth as a minimum? And what drives that the most, I guess, without asking for more guidance. But is it topline or is it margin improvement? How should we think about that?

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

Let me give you a little bit of it. It is topline obviously, as we built a very good backlog going into '18. And on the margin side, I mean, listen, lot of those margin issues are under our own control. As Hudson said, I think we've had a little growing pains. We've run some of these operations very, very hard. We've decided to take a turnaround in the fourth quarter in one of the catalyst operations really to get some of the reliability performance back to where we need to do. So that's, that's an additional opportunity on that side of it. But so it's really the combination of those aspects to it. I would say, relative to the outage, the cost of the outage -- we incurred more cost than we initially thought we would as we -- changing our systems around, changing those supply chains, lining out where to make progress in one plant versus another, and so on and so forth. And we've spent a lot of time in the first half of the year lining that out, and that'll be all lined out and -- as we exit 2017.

Operator

Our next question is from the line of Michael Sison of KeyBanc Capital.

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

In terms of 2018, I appreciate you giving us an outlook for sort of a minimum outlook there for EPS. Just curious, so what if Takreer was online, how much more EPS growth would you get? And then can you redeploy sort of that capacity that maybe you're kind of waiting for that to come back on to other areas and make that up?

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

The risk of giving '18 was, Mike, just -- risk of saying anything about '18 was just of going further. I don't want to go further into that. I wanted to give you a point estimate as where we are today on that side of it. Obviously, if Takreer comes up, we can redeploy that capacity within the FCC business we have. And it'll be impact it from both the margin standpoint as well as a revenue side.

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

I'll add one thing, if I may. We do have enough flexibility in our capacity, Mike, to supply Takreer when it comes up and to supply the business that we're acquiring now.

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

Got it. And then you talked about Specialty Catalysts, it looks like demand there continues to be really strong. And you talked about new catalysts that you're coming up for polyethylene and polypropylene. Anything in particular that customers are looking for in terms of that catalyst and how can that continue to drive new growth?

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

It's a great question Mike. So when you look at the world from the eyes of our customers, they're pushing their performance to higher, more demanding plastics applications for their polypropylene and polyethylene products. And a big, big part of that equation is catalysts. It's what's driving the demand for our CONSISTA non-phthalate polypropylene catalyst. It's a high performing catalyst that gives our customers the ability to make much higher value resins in their operations, which is obviously, higher margin and more money for them. Similarly on the polyethylene side, the commercial work, the technical work that we're doing with our customers right now, is really focused on helping them create higher value resins, so that they're making more money. And that's our basic business model.

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

Great. And just one quick follow-up there. Any opportunities Fred, maybe to do more acquisitions in this area?

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

Yes. There are. And our pipeline is good. I would tell you that we're studying as we always do, a number of opportunities, and I'll leave it at that.

Operator

Our next question comes from the line of Chris Kapsch of Aegis Capital.

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

Couple of follow-ups just on the -- this, I guess spot market business that you acquired. Can you just talk about the timing, when did that flow through? And typically the sort of independent refiners (inaudible) such good characterization put this up for bid for a period of time 1, 2, 3 years? Can you characterize the wins here for the supply agreements that you've acquired?

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

Chris, Hudson again. The -- good question, it allows me to clarify something maybe. The big wins that we had in Q2 were not spot business. One was a multiyear long-term contract with a customer in Asia. There were some setup costs associated with that account as we begin. It's a new customer, new units and there were some setup costs associated with that. The other one is a trial with another -- this one is a trial with another Asian refiner of resids, a polypropylene-type application, very high-demanding application and we're trialing a new catalyst technology with them. And so those really were the biggest opportunities that drove our growth in Q2. We did have some bid business. That's part of the business. It's always part of our portfolio. I don't think it was any more or less in Q2 than it typically is. Usually, those are fairly short duration, probably, a year give or take.

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

Okay. So in terms of what was weighing on the gross margin? Was it more of the former 2 strategic wins? Or was it more of the bid business? Or was it both? And...

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

It's mostly the 2 strategic wins.

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

Okay. And but just to be clear those are situations that you won based on the performance of catalysts, not on pricing, correct?

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

No, that's right. And to further clarify, these are one-time costs, not ongoing costs.

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

Right. And then, I wanted to follow up also on your characterization of the drivers for the catalysts industry more generally in response to, I believe it was Chris' question. You mentioned demand for transportation fuels and then this shift towards propylene maximization. One driver that you didn't mention for FCC's, although, in the context of HPCs you did. It was really just the crude slate, and I think also just crack spreads in general drive demand for FCC, the heavier the crude slate, the wider the crack spread, the more likelihood to process the heavier crude, which takes more FCC demand. Do you see -- is that a correct characterization first of all? And then can you talk about with the light type shale-derived oil coming back on stream with rig counts and so forth, can you just talk about your outlook for the global slate of crude and how that may influence FCC demand over the next couple of years?

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

Yes, Chris. I think your characterization of everything is how we see it too. When I rank the drivers of our growth, demand for transportation fuel, is first, in terms of significance. Second is the demand for propylene coming out of FCC units. And then third, you get into the effects that you're starting to discuss around crude slates and things like that, that is part of the equation. But it's a smaller variable than the first two.

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

Okay. And then indulging me with just one more because you talked about a couple of new units coming on in, I believe the Middle East and Africa and those could be substantial, I guess, given that the overall FCC industry is still running tight. But in the context of teaming up with an E&C company or a licensor or process licensor. Do we know, do you guys know, if you are the catalyst of choice? Or is that still something that's in negotiation you're trying to sell to the technology licensing companies or the E&C companies for those large projects?

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

For the most part, Chris, those are separate decisions, but -- that our customers make. And the point that Fred was making earlier, is that there is a lot of value to be created by starting to collaborate and combine those decisions. But today, the customers do treat those as separate decisions. And to your specific question about are we the catalyst supplier of choice, the answer is hell yes.

Operator

And your next question is from the line of John Roberts of UBS.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

In the silicas Materials Technologies segment, volume in the continuing product seems to be growing less than the end market growth rates of pharma and coatings and consumer and chemicals. What's the organic growth outlook like for the continuing products there?

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

So in the -- on the silica side of this business, we think we're growing a bit faster than the underlying end markets. What you're seeing is the effect of the headwind from our fine chemicals business and the pharma, which has been down significantly this year.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

Okay. Can you break that out so we can actually see what the silica's growth is? Or when does fine chem sort of wash out of the numbers here?

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

Yes. I -- the silica's growth is 4%, 5% year-over-year in the first half. And then, we're getting a headwind on fine chemicals obviously.

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

I mean, we've really washed it out of the numbers for the second half, completely on that side of it, second half of '17. And at this point in time, it not included a large pick up into '18.

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

Fred's comments are on fine chemicals.

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

Fine chemicals, right.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

Okay. With the Takreer FCC unit down, that gasoline demand must be made up by other refiners. Can you actually tell if you've picked up your share of that incremental demand that's gone elsewhere? Or because the gasoline market is so large and as inventory changes, you can't really tell if you're picking up some of the lost Takreer FCC demand and just other units running harder across the industry?

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

We can't tell specifically at the unit level. But generally, that gasoline demand is being made up in the Middle East and Europe. And we've got good market positions in both of those regions.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

So do you think you've picked up your share as that's moved around? Or you've lost -- obviously, it's a net negative...

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

I have no reason to think we've lost any position.

Operator

Our next question is from the line of Mike Harrison of Seaport Global securities.

Michael Joseph Harrison - *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

Was wondering on the polypropylene licensing side, you've announced a couple of deals now. I was wondering if you could give a little bit of a better sense of the magnitude and the timing of the revenue and earnings contribution? I guess in general, should we expect to see those start to contribute about 6 months from the time they're announced? And then specific to the deal you announced today, you're saying it's going to be serving the biggest polypropylene line in the world and part of a bigger chemical installation? So is this project going to be longer in duration and maybe take longer to start to contribute and see the longer-term contribution?

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

So we're not going to quantify the value of individual licenses. But the way that we see the revenue flow, typically, there is a small amount of revenue at the time of sort of upfront in the project, when engineering packages are delivered and so forth. And then, the -- during the startup period of the unit, we recognize revenue as we're doing work, supporting our customer with that start-up period. And then once the unit is up and running successfully, we get a final payment and that's the final piece of the revenue recognition. For any one unit, that probably could run over of -- it depends on the unit, 2 to 3-year cycle, where all of the revenue from a license would be recognized.

Michael Joseph Harrison - *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

All right. And then switching over to the Materials side of the business. You called out the higher manufacturing costs there. I was wondering if you could just give a little more color on that. Is that a scale issue where you had exited products and obviously, not getting some of this fine chem pharma volume yet? Or can you talk about some of the other issues that are going on there?

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

Sure. One of the pieces is, we commented briefly in the script that we had an outage at our largest facility.

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

Turnaround.

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

I'm sorry. Wrong word choice. Turnaround. Let me be really clear, a planned maintenance turnaround at our largest facility. And that obviously impacted costs. It showed up some in the catalyst business. It showed up in the Materials Technologies business as well. That's a piece of it. We did have some hiccups in a couple of the plants in Materials Technologies during Q2 as well. And frankly, we had as we compared to last year, we had really good costs last year that didn't repeat and a part of it's just the year-over-year comparison.

Michael Joseph Harrison - *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

And can you quantify the impact of the turnaround in terms of EBIT?

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

We spent, not all of this is running through Q2 earnings. But we spent a few million dollars in maintenance costs and a couple of million dollars in capital.

Operator

Our next question is from the line of Laurence Alexander of Jefferies.

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

Couple of longer-term questions. If you look at the pipeline of catalysts or large projects that you spoke about as candidates or targets, has that changed your thinking about the longer-term CAGR for the catalyst business? Or is that just more supportive of your longer-term target? And given what -- the way you characterize 2018, it'll be easy to walk away from this call with the impression that 2019 has setup to be a bit of a hockey stick kind of year, both with the full ramp of these larger catalysts wins flowing through, coupled with Takreer finally turning on and so forth. Is there anything on your radar that would mitigate, would offset, or argue for some caution on the longer-term 2019, 2020 trajectory?

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

Yes, Laurence, this is Fred. Let met answer the second part of it. Again, we feel very good. Hopefully, it came out in the call. We feel very good about the positioning of the market and the demand that we've seen in not only from an FCC standpoint, but from Specialty, the license picking up and so on. So the market feels very good, and our products are well-positioned to capture that. So I don't see anything today that is a headwind out there, '19 and beyond, at this point in time. And the volume that we're securing are generally longer-term contract-type volumes both across our businesses, and including the license side of it. And my last point was that's why I talked about the framework guidance that we put out in May. I'm comfortable with that guidance. You see that on the revenue growth side, and I think it's supportive of what we're doing now. And we'll see, if over time, we can move that up. But at this point in time, I'm comfortable on that guidance.

Operator

Our next question comes from the line of Chris Shaw of Monness, Crespi.

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

Just some sort of clarifying questions. One, on the insurance recoveries, is there opportunity for insurance recoveries in 2018 as well? Or is this a 1 year thing?

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

Chris, it's Tom. It's one loss and has a maximum of $25 million. And like we said, we'll get through that by the end of this year. So there won't be any insurance proceeds related to the customer outage in '18. And that is factored into the guidance we gave earlier, and our feeling about the minimum 7% EPS growth.

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

Okay, I wasn't sure how that worked year-over-year. And then the new wins for FCC, I mean, somewhat they've redirected the business from Takreer. Are those -- when those wins become I guess more mature in a year or so, is that the kind of a business that -- would you expect that the margin in that business to be higher than say what Takreer was earning, or at least higher than normal segment or at least in line with normal FCC? Just trying to figure how to look at that.

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

Yes, Chris, Hudson. The -- once, we get pass these upfront costs. These are our great margin customers, and they're using our best catalyst technology. And that creates an anonymous amount of value for them, and we capture some of that value. We expect those customers to be positives for our margins going forward.

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

Okay. And then just finally, Materials Technologies and the slowdown in some of these pharma customers. How quickly did that turn, I mean, I'm just curious, is this something that you would have seen maybe earlier -- at the beginning of the year or leading into the year? Or is this something where they suddenly just had to turn off the spigot themselves, and thus, the demand has gone away?

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

Yes, it was a little different with each customer. In a couple of cases these were regulatory developments that were different than expected. In a couple of cases, they were slowdowns in demand that we saw coming, but I think we were off in the degree.

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

And just curious, how does that color your view -- how you guys go about getting -- filling the pipeline again? I mean, do you change the sort of -- not the customers themselves, maybe, the type of products you're looking to supply.

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

It's a good question, Chris. This is -- where we -- we've kind of taken a step back and said how do we want to manage the pipeline and product portfolio for this business. And frankly, as you all may recall, we have a new President leading this business. She's got great experience in the space, and she's brought a lot of insight into how to do this well going forward.

Operator

Our next question is from the line of Roger Spitz of Bank of America.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Do you expect the business interruption insurance to be able make it all the way through Q4 '17? You've got a max, I guess, you're saying of $25 million. Or does it run out somewhere in the middle of Q4 or right at the end of Q3?

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

Roger, we got a couple of different scenarios in our outlook. So the timing is kind of hard to pin down. But we know, by the end of year, it'll be exhausted.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

And in Chinese MTO, you've been talking about strong, I guess volume growth there for you. Is that a matter of your new product taking share, perhaps a little bit from your older product or from other people's products? What I'm trying to think about is underlying MTO demand, we believe the MTO -- Chinese MTO cost position is relative to the olefins cost curve. And how often those -- the Chinese run their MTO plants. I'm just trying to understand what is the growth pattern here?

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

So our strategy is to capture our fair share of the existing MTO units. And there is a question about how much capacity will be added in the future for the economic reasons that you referenced. But that's not something that we're playing for right now. Right now, we're focused on capturing our fair share of the existing operations, and we're doing it with better technology. We've got a technology that allows our customers to run their units better and make more money. And that's what's driving our penetration in that market.

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

Let me add one other point on that, Hudson. And we have a local manufacturing operation. We're making catalysts in China. So that, that coupled with the technology we're bringing. We've been successful.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Got it. And by the way is that a continuous feed? Or you put in a load and when it gets used up, they drop the load and replace?

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

The latter.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Latter. And can you talk anything about the proposed Abu Dhabi FCC catalyst plant? I suspect, it's pushed back to some extent. Can you talk anything about the timing?

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

It is still something we're absolutely committed to doing. As we have been, we're managing the timing of that investment relative to the demand in that region.

Operator

(Operator Instructions) And we do have a follow-up question from the line of Robert Koort of Goldman Sachs.

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

Chris again. Just on these new FCC projects you're working on. I was wondering if you can give a read on the price mix that you guys might be looking at or customers are looking at. If there's going to be any uplift from that? And then maybe just any commentary on the current pricing that you've saw in the second quarter, and you think you might get for the rest of the year?

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

So as I commented, Chris, these are high-value catalyst applications. And there -- they create significant value for our customers. We do capture our fair share of that value, and I'll leave it there in terms of customer pricing.

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

Just really quickly, does the pushback at Takreer, does that delay in anyway your expansion in that region, and then do you lower your CapEx for the next to 18 months or so?

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

We do want to time that investment with demand in the region. And we are continuing to spend money on that project now. But the big spending will be timed with the demand in that region.

Operator

We also have a follow-up from the line of Chris Kapsch of Aegis Capital.

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

Yes. Just I wanted to have a follow-up on the Materials Tech and the fine chemicals weakness, in particular. Are those more, I think you mentioned pharma fine chem, but are they all pharmaceutical customers or they're also agricultural customers? The reason I ask, I just want to kind of understand if it's regulatory developments that's causing weakness there that could suggest, I don't know, generic competition, influencing the demand for your customers products. If there's anything in ag, it could be just some cyclical driver. So just a little more color parsing that out will be helpful?

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

This is a pharmaceutical principally, we do have some nutraceutical applications, nothing in agriculture.

Operator

Thank you. And at this time, I am showing no further questions. I'd like to turn the call back over to Ms. Almond for closing remarks.

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

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

Operator

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