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GRA - Q3 2017 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 3Q17 sales of $430m and adjusted diluted EPS of $0.90. Expects 2017 sales growth to be 6-7%.

CORPORATE PARTICIPANTS

Alfred E. Festa *W. R. Grace & Co. - Chairman & CEO*

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

Tania Almond

Thomas Eric Blaser *W. R. Grace & Co. - Senior VP & CFO*

CONFERENCE CALL PARTICIPANTS

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

Christopher John Kapsch *Loop Capital Markets LLC, Research Division - MD*

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 *Crédit Suisse AG, Research Division - Director of Equity Research*

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

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 Sison *KeyBanc Capital Markets Inc., Research Division - MD & 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 W.R. Grace & Co. Third Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to hand the floor over to Tania Almond, Investor Relations Officer with W.R. Grace. Please go ahead, ma'am.

Tania Almond

Thank you, Karen. Hello, everyone, and thank you for joining us today, October 25, 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 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 Investors 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. 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.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Great. Thank you, Tania, and good morning, and thanks, everybody for joining. Grace had solid performance in the third quarter, with sales up 6% and adjusted EPS up 13%. This is the fifth quarter in a row of year-over-year top line growth and the third quarter in a row above 5%. Demand was strong across all of our businesses, driven by our value-added products. And as expected, we achieved sequential gross margin improvement.

Overall, I'm very pleased with the way our teams managed through Hurricane Harvey's impacts on our customers and logistics in the region. The hurricane reduced EPS by approximately $0.04 in the quarter. Our strong operating discipline continued to generate cash flow giving us optionality and flexibility to achieve our growth plans. From our vantage point, the global economy continues to show good demand growth.

We have raised our sales outlook for the full year to 6% to 7%, tightened our EPS growth toward the high end of our range, now 8% to 10%, including the impacts from the hurricanes. We also expect to generate over $265 million of adjusted free cash flow as we exit 2017.

This morning, we announced an FCC catalyst price increase effective January 2018, reflecting the strong demand for our new Catalysts Technologies as well as rising raw material and energy costs.

Specialty Catalysts and Materials Technologies are also implementing price increases for many of their products. In Refining Technologies, we saw good performance. Our custom product technologies and technical support continue to improve refinery operations.

In our Specialty Catalysts segment, demand across our polyolefins business remains robust and is especially strong for our 6th generation non-phthalate catalyst. We are well positioned to benefit from the big polyolefin units that are coming up on the Gulf Coast. Our licensing pipeline is very healthy. And just this week, we signed another licensing agreement.

Materials Technology continues to be successful in a strong market for silica gel, colloidal and other industrial applications. Our teams have made good progress toward rebuilding our fine chemicals pipeline, where I expect to see some growth in the upcoming year.

As I look ahead, I feel very good about our operational and manufacturing excellent actions, which will be essential in capturing the opportunities, created by our great products and strong markets.

With that, I'm going to turn it -- the call over to Hudson to give you some more details on our business performance.

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

Thank you, Fred. Let's start with the Refining Technologies. From a market perspective, low crude prices continue to support good demand for gasoline and propylene from FCC units. Global gasoline demand grew 1.1% in Q3 with miles driven in the U.S. up 1.2%. Global refinery utilization increased and global gasoline stocks decreased, all positive data points for our business.

For Grace, FCC catalyst sales were up 7% year-over-year, reflecting good market demand and very good commercial performance for our premium catalysts and propylene maximization technologies. These products help refiners increase their profitability and maximize the value of petrochemical and alkylate feedstocks. Our customized technologies and technical support have improved many refineries' margins by more than the $1 per barrel versus the alternatives.

FCC catalyst prices have been improving this year, and we're up again in Q3, adjusting for the effect of customer disruptions on customer mix. We continue to make significant investments in new Catalysts Technologies, technical services and manufacturing capabilities. And we face rising costs for key inputs like rare earth, caustic soda and natural gas. As a result, we are increasing FCC catalyst prices as announced earlier this morning. This price increase follows the strong advances we have made in product technology over the past couple of years, creating significant additional value for our customers. We intend to implement the price increase on a customer-by-customer basis as contracts allow. The 3% to 9% range reflects different increases for different products in our portfolio.

Our ART joint venture is having another strong year with good demand for our hydroprocessing catalyst technologies. Year-to-date joint venture earnings equal last year's record pace, although Q3 earnings were below last year's Q3 by $4 million due to order timing within the year. ART's performance has been driven by higher resid and hydrocracking catalyst demand leading to improved product margins as well.

These technologies help our customers meet increasing environmental standards for their products. We are working very closely with a Middle East customer that experienced an outage earlier this year to help them determine a restart strategy and time line. We continue to assume no catalyst sales to this customer in our 2018 business planning.

Let's turn to Specialty Catalysts. This business grew 8% in Q3 with the highest growth in Asia. Strong sales for our high-performance CONSISTA non-phthalate catalysts continue and sales of the LYNX catalyst acquired last year are tracking to our plan. From a market perspective, demand for plastics continues to grow faster than global GDP. Our customers continue to invest in new capacity, and we are well positioned to grow with them as their investments come online in the U.S. Gulf Coast and around the world.

We see this in our catalyst business and in our licensing business. Our licensing pipeline includes 9 projects expected to reach decision points over the next 12 months. Our licensing backlog is up significantly over the end of last year, and we expect to add to our backlog with additional project wins in Q4. As a reminder, licensing revenue is recognized over several years as each project progresses and starts up. These licenses also lead to future catalyst sales when the new units come online.

Hurricane Harvey affected our refining and petrochemical customers on the U.S. Gulf Coast and affected our catalyst sales and earnings. 60% of U.S. polyethylene and polypropylene capacity was off-line in early September. 2017 earnings will be lower by about $6 million, including $4 million in Q3 and $2 million in Q4. These lower earnings result from lower sales and higher operating and logistics costs.

The hurricane did not significantly affect our plans, though some operations were shut down during the storm and for a few days after. We are very proud of how our teams managed throughout this event. We operated safely at a challenging time and never missed a shipment to any of our global catalyst customers.

Now for Materials Technologies. MT grew 5% year-to-date, excluding last year's divestitures. Our silica's business has grown 6% year-to-date. Growth has been strongest in the industrial product lines led by mission control applications. In coatings, we're starting to see increased demand for TiO_2 extenders resulting from rising TiO_2 prices. This growth has been offset by much lower sales in our pharma fine chemicals business. We have made good progress rebuilding our pipeline and expect sales growth to return in the second half of next year.

In Q3, we made 2 small acquisitions in Materials Technologies, both were in the consumer pharma space, where we see good growth and profitability for our technologies. These acquisitions reflect our focus on maximizing the value of our silica technology through continued growth investments.

Let's discuss operations, and then I'll turn the call to Tom. Last quarter, we described growing pains in a few of our plants, where higher sales growth rates have increased capacity utilization. We made good progress addressing these issues in Q3 and setting a stronger foundation for improved performance in the future. You see this best in the sequential improvement in gross margins. We still have much work to do, but we took a good step forward in Q3.

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

Thomas Eric Blaser - *W. R. Grace & Co. - Senior VP & CFO*

Thank you, Hudson. Let's turn to the quarter results. Grace's third quarter sales were $430 million, up 6% on good volume growth versus Q3 last year. Adjusted EPS for the quarter was $0.90 per diluted share, up 13% from last year. Adjusted free cash flow year-to-date was $249 million, which compares to a $191 million a year ago, up 31% and is in line with our full year expectations.

Adjusted EBIT for the quarter was $108 million, up 5% versus last year. Operating margin was 25%, up 100 basis point sequentially, principally reflecting improved performance in our plants as expected. Our adjusted EBIT return on invested capital on a trailing 4-quarter basis was 25%, up 70 basis points from last quarter and up 100 basis points from the end of last year.

Looking at our business segments. Catalysts Technologies sales were up 7% versus last year on volume growth and currency benefit. Regional mix continues the shift we experienced in the first half of the year with North America volume down 6% and Asia up 73%. Latin America was down 53% in the quarter, mainly due to the timing of contract renewals in the region but also suspended sales into Venezuela.

In the third quarter, we recorded a $10 million charge to fully reserve for a trade receivable from a Venezuela-based customer as a direct result of the recent political unrest and economic sanctions. This charge has been excluded from adjusted EBIT due to the abnormal circumstances affecting the customer's ability to currently honor its obligation.

Adjusted gross margin was 41%, down 320 basis points from last year but importantly up 100 basis point sequentially reflecting operational improvements, improved regional and product mix and improved pricing partly offset by the hurricane impacts.

Adjusted EBIT grew 10% in the quarter versus last year. Lower gross margins and lumpiness of ART JV timing between Q3 and Q4 of $4 million were more than offset by $12 million of insurance recoveries related to the Middle East customer outage. In the third quarter, we reached the maximum insurance recovery of $25 million related to that event.

In Materials Technologies, sales were up 3% versus last year on currency benefit and volume growth coming from Asia. Our silica's growth was 7% partly offset by lower pharma fine chemicals. Gross margins improved 60 basis points, and adjusted EBIT was flat with higher gross profit offset by higher expenses.

In the third quarter, we spent $35 million on share repurchases at an average per share price of approximately $69. Today, we announced our quarterly dividend equal to $0.21 per share with payment expected on December 7.

Let's pivot to our 2017 outlook. As Fred mentioned earlier, we now expect EPS to grow 8% to 10% on sales growth of 6% to 7%. We also expect adjusted free cash flow to be in the range of $265 million to $275 million, up 12% to 17%, which includes capital expenditures in the range of $140 million to $150 million.

In addition, adjusted EBIT will be in the range of $412 million to $417 million and adjusted EBITDA in the range of $522 million to $527 million, both of which incorporate the $6 million impacts of the hurricanes. Going forward, we plan to simplify our guidance metrics to focus on the critical items. We will make some of these adjustments in our communications next quarter.

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

Now I'll turn the call back to Fred for closing remarks.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Thanks, Tom. As we close out the year and prepare for 2018 beyond, our businesses are well positioned to capture the growth we see in our markets, and we remain on track with the 5-year framework we presented in September. As we complete our planning process for 2018, which reflects the extended customer outage and no additional insurance recoveries, I remain confident we can achieve a minimum 7% EPS growth, generate high cash flow to fund growth, increase our dividend and continue our share repurchase program.

Lastly, we are hosting our next Investor Day in the first quarter of 2018, and we will be soon sending out save-the-date notices.

With that, operator, we'll open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Kevin McCarthy with Vertical Research Partners.

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

Just wondering if you could elaborate on the drivers of the proposed price hike in FCC, whether it's industry capacity utilization, your competitive standing, raw material costs, et cetera. And then also with regard to the range of 3% to 9%, if we were to think about an average expectation, can you help us understand, perhaps, time line of implementation? And whether the average over that time line will be an arithmetic mean of the brackets there or skewed?

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

All right. I'm going to let -- Kevin, I'm going to let Hudson talk about this.

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

Kevin, so the primary driver for the price increase is the value of the technology that we're bringing to our customers now. Over the last couple of years, we've made significant progress improving the performance of our catalysts, and we think that that's very supportive of what we announced this morning. There is a component of this that is related to increasing inflation and investments that we're making in the business, but the primary driver is the value of the technology we're bringing to our customers.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

I would also jump in and add that as we've seen this year, the FCC units are running very hard. They're running very hard for both propylene as well as for gasoline, and that capacity utilization continues to tighten across the globe.

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

And then moving to the Harvey-related impacts. I heard you call out $6 million. Is all of that concentrated in the catalyst business? Or is there any impact in Materials Technologies? And would you expect all of the storm-related impact to be washed out in 4Q?

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Yes. You're right. This is Fred. It's all primarily catalysts. There may have been some logistic issues on the materials side, but -- and primarily specialty catalysts around the big polyolefin units that didn't run in the fourth quarter or on the third quarter on the revenue side. We've got a little carryover, about $2 million, that we're forecasting in the fourth quarter related to some costs as well and some revenue.

Operator

And our next question comes from the line of Christopher Parkinson with Crédit Suisse.

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

Can you just talk a little more about Catalysts Tech mix in the quarter as well as your expectation for 4Q? And anything you're willing to give into '18 just parsing out FCC, the MTO growth as well as are there any year-over-year effects from Takreer when it's temporally online in the second half? Just any color on these and how they translate into forward-looking metrics would be helpful.

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

Chris, you packed a lot into that question. No, no, no, it's okay. Let me hit on some of the pieces. I think your -- the start of your question was around mix, and I like the mix improvement that we're seeing in our catalysts business. On the refining catalysts side, we're seeing improved mix around customers adopting these very high-value catalyst technologies. Fred mentioned it a moment ago. Customers are running harder. When they're running harder, they want the best available catalysts. And we're seeing strong demand for those high-value technologies. And Specialty Catalysts, the same. As our CONSISTA product line has matured and adoption has increased, that helps us from a mix perspective. In the ART business, we're seeing improved mix as more and more customers are using our hydrocracking technologies. You had a question about Takreer...

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Let me jump in on that point a bit. If you think about it and just step back on a qualitative basis, as we look at our third quarter and strip out all the insurance recoveries and then add in the effective what the hurricane hurt us and timing on our hydroprocessing sales from third to fourth quarter, we'll essentially have been better this year than we were last year, and last year had the Takreer volume in it. And if you look out to the fourth quarter, we'll essentially be in about the same position or a little bit better on that side. So we've made nice progress, especially in the second half replacing that Takreer volume. In -- as we go into '18, we'll continue to work on that and focus on that mix of that business. Hudson -- I'm going to give Hudson a little bit credit here on the MTO side. He and his team and Tom Petti and those guys have done a wonderful job on the MTO market in growing. And we had another great third quarter on that side as well. So you're seeing a little bit of a mix, but I wanted to give you that context of with and without Takreer, especially the second half.

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

Great. And just a quick simple follow-up, sorry. Can you just give a very quick update on the ART JV? How your efforts are evolving and any strategic initiatives or opportunities you see for the platform over the long term?

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

We -- ART has had a very good year. Last year was a very good year. So the year-over-year compare is close to flat, but 2 strong years. We see good demand for products in that business. It's really driven by increasing higher environmental standards for transportation fuels. That's a strong growth tailwind in that business. You asked about strategic initiatives. We're investing in that business to add capacity. And that's an important part of our growth trajectory for that joint venture.

Operator

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

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

This is Chris Evans on for Bob. I was wondering in the catalysts segment, strong volume growth again. Are you fully offsetting or replacing some of the sales you made in the prior year quarter to Takreer? And do you expect that in the fourth quarter when you had the -- a full quarter impact that you can do the same?

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Yes. Go ahead, Hudson. Yes.

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

We have made good progress. It's been a priority for us this year, and we've made good progress bringing our best technologies to customers all over the world. Probably the biggest single adoption area has been in East Asia.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Yes. I think as we look to the fourth quarter, I think we're seeing sequentially we'll grow our top line 5% to 6% from the third quarter. So -- and that will be strongly supported by the catalyst volume.

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

Great. And then if you could just sort of expand on the prior question on ART, pretty much flat year-to-date versus the prior strong year. It sounds like you guys are pretty bullish on those expectations. So I guess when you kind of think about how things are lining up, do you expect the fourth quarter to -- how timing shaped up, do you think that would be a growth period for the segment for JV?

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

I'm sorry. The period you're referring to is what?

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

So I guess looking at the fourth quarter for ART and some of the timings you had year-to-date, you seem to have a bullish view that this should be something a segment or a process that's up year-over-year. Just kind of curious if that's going to play out in the fourth quarter or more into '18?

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

Yes. We'll see improvement Q3 to Q4 in ART. I think for the full year, our ART earnings -- our ART joint venture earnings will be line with last year. But again, we feel pretty good about 2 really strong years back-to-back. And when we get to '18, we do start to see additional earnings growth in ART.

Operator

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

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

This is Jacob on for Mike. It looks like you guys narrowed the EPS guidance but lowered the EBIT guidance a little more. Does this imply that you're expecting a lower tax rate next quarter?

Thomas Eric Blaser - *W. R. Grace & Co. - Senior VP & CFO*

Yes, Jacob, it's Tom. Yes, we've been working in number of tax strategies over the last 9 months. And as we complete those projects, we're starting to realize the impact of that. And so we will see a lower effective tax rate for the year. And then I think the other thing you need to consider is we don't plan for option exercises and the windfall tax benefit is that flows through as an upside to our planned tax rate.

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

Got it, okay. Could you quantify the -- what do you think the Q4 tax rate will be?

Thomas Eric Blaser - *W. R. Grace & Co. - Senior VP & CFO*

We don't provide that information.

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

Okay. And then maybe a question on the price increase in FCC catalysts. Is there you see any the prebuying associated with it that you might see in the fourth quarter?

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

Our plans are running pretty hard right now. We don't expect any significant prebuying.

Operator

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

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

Hudson, could you just talk a little bit about the operational excellence? What you've done there? How much there is to -- more to do? And then could you see a larger emphasis as we head into 2018? And then, Fred, can you just talk about -- I know you guys did the 2 deals, small deals, but can you talk about the overall deal environment just broadly?

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Sure. I'll let Hudson go first.

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

Okay. So from an operations perspective, what we've seen this year if I go back to the early part of the year is strong demand really in all of our businesses took the capacity utilization in our plants up a notch. And to be frank, we weren't fully prepared for that in all of our plans. And so we had some reliability challenges, and we've been dealing with those. We took a big step forward in Q3. We're going to take a big step forward in Q4 to make sure that those plants run well at high utilizations. But it's not a 1 or 2 quarter fix. This is something that we'll be working on into next year. We're building some new muscles, and I feel really good about the progress we've made.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Yes. Ben, regarding the acquisition, the M&A standpoint, as we said coming out of the spin, we wanted to be really focused on acquisitions around the catalyst materials side. We did the one on BASF as we came out. I would tell you, right now, our pipeline is very active. And that's probably enough to say.

Operator

And our next question comes from the line of John Roberts with UBS.

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

This is the first quarter in a while that silica products wasn't impacted by exited products. Is there -- will that be true in the fourth quarter? And going forward, do we have any more cleanup to do in the portfolio? And then you talk about 5% growth there year-to-date. It's been pretty lumpy quarter-to-quarter and actually it is only one quarter in the slide that has volume growth that's close to that. Should we expect it to be lumpy going forward? And what causes the lumpiness there?

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

John, this is Hudson. We have, what's the term, lapped the divestitures from last year. That was as of June 30 probably. On the lumpiness, the biggest lumpiness that we've seen this year is in the comparison to the 2016 Q1. You may remember back then there was some concerns about growth rates in China. We saw significant inventory correction in our Asia business at that time, and that produced the year-over-year lumpiness that you see this year.

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

Right. And then you indicated that your 2018 business plan doesn't have Takreer restart in it. I think, Fred, you earlier talked about Takreer was studying some options for partial operation while they completed repairs. Have those options been fully evaluated now and are viewed as nonviable?

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

That evaluation is continuing. And as I said, we'll make a commitment to you when we know the results of those options. But there's still being -- there's still -- we're still in process with Takreer of evaluating those.

Operator

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

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

I have 2 quick questions. First, can you flesh out a little bit how your thinking has evolved on the cadence of demand on the MTO side? How many more years before that market might taper off? And secondly, given the volume growth that you're seeing in the FCC side, what's the -- how long can you run at this kind of cadence before you need to start looking at your own capacity additions?

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

Laurence, on MTO, we see continued growth opportunities into next year and '19 and maybe beyond. But our planning horizon isn't quite that far on that product line. But we've had good growth this year, and we think that will continue. On FCC capacity, the -- we have a larger expansion planned in the Middle East. But we are doing work now to add smaller amounts of capacity in our plants in North America and Europe to make sure we can continue to supply the growth that we're seeing.

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

And are those 2 together, probably, those should suffice for at least the next 3 to 4 years. Is that right?

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

I think within the window -- you mean including the Abu Dhabi facility?

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

Yes.

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

Yes. With that facility, that would give us growth capacity for the mid-term.

Operator

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

Christopher John Kapsch - *Loop Capital Markets LLC, Research Division - MD*

So you sounded somewhat bullish on the prospects in your -- the licensing portfolio, given, I guess, activity and backlog, and you talked about -- a little bit about how you anticipate maybe some of that -- those commercial successes flowing through. I'm just wondering if you could elaborate on some of that in terms of the implications for the segment growth rate and its margins and maybe even the returns on capital. And then maybe more generally because, Fred, over the last, I don't know, 6 months or so, there's been an evolving narrative about the rationale for catalyst companies and licensing companies to combine strategically and what the merits behind that are. Just wondering if you -- given then some of you areas you have both sides if you think of that as a razor, razor blade, you have the licensing and the consumable catalyst piece. Can you just elaborate on examples maybe of where that combination has actually led to greater probability of success, if there's some specific examples of that? If -- how the customers appreciate that? And just want to kind of understand the kind of the rationale for the notion that it makes sense for those sorts of combinations?

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

Let me go first. I think we have 2 great examples on the licensing side, one being the UNIPOL licensing, the licenses that we've had and that take up on the catalysts, on the back end. They do. They go hand in glove. And you get the license first and then you get the catalyst second. But the combination of both are more than 1 plus 1 because you have a stickiness with your customers and then you're in those customers and you end up upgrading both from a license perspective on some of the processes as well as from new catalysts as we may start them off on 1 catalyst and upgrade that. The second great example is within our joint venture with Chevron Lummus in the CLG connection. When we put that together, I don't know, 4, 5 years ago on that side of it. On the license side, we have seen a tremendous value and uptick on the amount of catalyst sales because of the support we're giving CLG on the relationship on that side for the new wins. And I think you see it, you see it, and I think CLG talks about it how they've won more licenses on that hydroprocessing, hydrocracking side of it. So those 2 are 2 great examples. We still are very bullish about it. I mean, from my perspective, strategically, I like finding more licensing opportunities. I like finding more catalyst opportunities and bolting on materials that extend our product portfolio. On the specifics on the license for UNIPOL -- or for what we've done, Hudson, I'll let you...

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

I'll just add a couple quick thoughts. The licensing sales do come at higher margins than the catalyst sales. And so we would expect that to be margin accretive as our licensing sales improve over the next few years. 2016 was the trough year for us on licensing sales. 2017, not much better. But with the backlog that we're building, we expect the next few years to be better.

Christopher John Kapsch - *Loop Capital Markets LLC, Research Division - MD*

And if I could just follow-up on that backlog, it sounds like what you're connecting that improved backlog to is largely the Gulf Coast build-out, which everybody has been waiting, I guess, for years following the fracking phenomenon, if you will. But just in terms of the flow through that was, do you get like a one-time licensing fee and then subsequent royalties for the life of the project? Or I think you referenced a finite number of years. If you could just kind of maybe, and maybe each project is different, but if you could just kind of generally characterize how that flows through as these projects are built out?

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

Sure. So with our business model, license, the sales from an individual license is recognized over a time period that begins when we sign the license and ends when that unit starts up, maybe a little bit after the unit starts up. And as we're helping the customer go through their engineering and start-up phases, we recognize revenue during that time period. It can be anywhere from probably 2 to 5 years would capture most of the range. 3 to 4 maybe the most typical. You made a reference to the Gulf Coast start-ups. That's not really what is driving this for us right now. Those technology decisions were made some years ago. We really -- when we see the new licensing pipeline, it's really Asia, the Middle East. There is some in North America, but the bigger part of it is in Asia and the Middle East.

Operator

(Operator Instructions) Our next question comes from the line of Roger Spitz with Bank of America Merrill Lynch.

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

Funding large potential acquisitions, how much would you let leverage increase? And would you ever consider partially funding with new equity?

Thomas Eric Blaser - *W. R. Grace & Co. - Senior VP & CFO*

Roger, it's Tom Blaser. Yes. So we thought about that a lot. And right now we feel like we're comfortable with 4x EBITDA range in terms of debt leverage. If we were going to think about equity, we have to see really high returns coming from that acquisition. So -- and it would have to be very strategic.

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

Great. And other question is can you provide your -- the silicon volume growth in Q3 '17 year-over-year and maybe year-to-date -- year-over-year, meaning not the whole segment, which you gave, of course, but just the silica portion of it?

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

Silica only was 6% for the full year -- for the year-to-date, I should say. And I think 7% just for the quarter.

Operator

And our next question comes from the line of Chris Shaw with Monness, Crespi, Hardt.

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

On MTO, your business there, have you ever given us an indication about the sort of the size there? I mean, is it -- nothing specific, but I mean, I'm just trying to think how meaningful it is over a $100 million in annual sales? Or can you give any indication there?

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

Chris, it's Hudson. The addressable market in China is order of magnitude $100 million. It's maybe a little bigger than that now, but that's the order of magnitude. And I think what we've said in the past is we want our fair share of that market. And we entered that market 3 years ago to -- probably 3 years ago. And we've been making steady progress towards getting our fair share.

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

Okay. And then the -- your growth there, has it been coming mostly from given that's a fairly new business, I guess it's going to be mostly new customers, but how much of it's been just new sort of new project wins and -- versus sort of I know the operating rates have been increasing as well. Can you give any idea how that breaks out?

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

Most of it's driven by new customer acquisition.

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

And then just on -- you mentioned the raw material inflation on -- as part of the reason for the FCC price increase. Is there any numbers you can give around how -- I guess how much the raw material inflation has been hurting margins over the past couple of quarters?

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

I think for the company, for the year, we're around 100 basis points.

Thomas Eric Blaser - *W. R. Grace & Co. - Senior VP & CFO*

That's correct. Yes.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

And we're seeing a little bit of a spike here in -- coming out of the third quarter, especially around caustic. I mean, around the hurricane impacts. As you could see probably with most of the companies you follow, caustic has spiked up dramatically.

Operator

And our next question comes from the line of Mike Sison with KeyBanc.

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

When you think about Catalysts Technologies, you've put up pretty impressive year-over-year growth in the second and the third quarter despite having 1 big customer challenge. And so when you think about '18, you've got pricing behind your back in FCC polyolefin catalyst continues to post pretty good demand. And so what type of growth do you think -- I mean, could you return to double-digit operating income growth in Catalysts Technologies next year given sort of the backlog of everything that you talked about?

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

Mike, we're not ready to go to that level of detail with you. We'll give you color on that in February. But we feel good about the progress we've made with customers, especially on these new higher-performing technologies. The pricing actions will help of course, and ART earnings, we expect to grow next year. So those are all pluses for us. I'll leave it there.

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

Then in terms of filling up your FCC capacity, where do you think you'll be at the end of '17? And if you continue to win new customers as you head into '18, how will you look at as you head into '19?

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

We're -- the plants are running pretty hard right now, Mike. And we've got productivity projects underway to make sure we'll continue to supply the growth that we see into the next couple of years.

Alfred E. Festa - *W. R. Grace & Co. - Chairman & CEO*

And I would add, Hudson and the team are doing a nice job of balancing the margin as well as from -- with the volume side of it. And I think, as we see Takreer come back up when it comes back up, there'll be a shift on that side.

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

Okay. And then one quick one on ART. If you think about the changeovers, how does that look next year versus this year? Do you think you'll have more potential next year, given what customers are telling you? Is it about even? How do sort of the HPC market look next year?

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

Yes. We're anticipating HPC volume growth into next year and some improved mix in that product line as well. Again, it's driven by -- remember the underlying driver for ART. It's driven by increasing fuel standards and its customers more and more refineries adopt their operations to make lower sulfur fuels. That's one of the big drivers for ART demand.

Operator

Thank you. And that concludes our question-and-answer session for today. I'd like to turn the conference back over to W.R. Grace for any closing comments.

Tania Almond

Great. Thank you very much, operator, and thanks, everyone for joining us today. If anyone has any follow-up questions, you can reach me at (410) 531-4590. Have a great day.

Operator

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