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GRA - Q4 2017 W. R. Grace & Co Earnings Call

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OVERVIEW:

GRA reported 4Q17 sales of \$460m and adjusted diluted EPS of \$0.98. Expects 2018 adjusted EPS to be \$3.72-3.82.



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CORPORATE PARTICIPANTS

Alfred E. Festa *W. R. Grace & Co. - Chairman & CEO*
Hudson La Force *W. R. Grace & Co. - President, COO & Director*
Tania Almond *W. R. Grace & Co. - Investor Relations Officer*
Thomas Eric Blaser *W. R. Grace & Co. - Senior VP & CFO*

CONFERENCE CALL PARTICIPANTS

Christopher John Kapsch *Loop Capital Markets LLC, Research Division - MD*
Christopher Mark Evans *Goldman Sachs Group Inc., Research Division - Research Analyst*
Christopher S. Parkinson *Crédit 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 & Equity Research Analyst*
Michael Joseph Harrison *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*
Tyler Charles Frank *Robert W. Baird & Co. Incorporated, Research Division - Associate*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2017 W.R. Grace and Co. Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I'd now like to introduce your host for today's conference, Ms. Tania Almond, Investor Relations Officer with W.R. Grace. Ma'am, you may begin.

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

Thank you, Jimmy. Hello, everyone, and thank you for joining us today, February 8, 2018. 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 on our 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, and good morning. Thanks, Tania. Our performance in 2017 was strong. We delivered 7% top line growth, 10% adjusted EPS growth and 16% growth in adjusted free cash flow. During the year, we achieved our sixth straight quarter of year-over-year top line growth, and we steadily improved our margins. These are terrific accomplishments against the headwinds we spoke about earlier in the year.

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2017 was more than the strong year of financial performance. We also made significant progress across the organization, which sets us up during the coming years to take advantage of strong market demand and to deliver on our longer-term goals. We demonstrated this in many areas. Our higher licensing win rate was reflected and a total of 6 agreements signed in 2017. In FCC, we grew the business despite the unplanned outage of one of our largest customers. In hydroprocessing, we continued to make progress in high grading -- in our high-grading strategy and see strong demand for clean fuels well into the future.

Materials Technologies delivered 7% sales growth in our silica business, and we've made progress in rebuilding our pharma fine chemicals pipeline. We're implementing price increases in all of our businesses to ensure we're capturing the value we create for our customers and to address inflation in raw materials. And we signed a definitive agreement to purchase Albemarle single-site catalyst business, accelerating our polyolefin growth. Overall, I'm very pleased with the accomplishments and progress in 2017.

Looking ahead into '18, we see the global economy continuing to show good demand growth for our value-adding products. We also expect continued inflation in raw materials across the chemicals sector, which supports price increases in downstream markets. For Grace, I feel great about our strategic position in the marketplace. Our commitment to investing in product and technology and leadership is paying off in stronger customer relationships. This, combined with our disciplined operating and financial management approach, will keep us on track to achieve our 5-year framework, that we shared with you last September. In 2018, expect continued sales growth, improved gross margins and double-digit EPS growth, including the effective tax reform. We anticipate another year of strong cash flow, enabling a step up in our investment in capacity and productivity to support end market growth and margin improvement.

With that, I'm going to turn it over to Hudson to give you a few more details on the markets and the businesses.

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

Thank you, Fred. I'll briefly review 2017 and then focus on our thinking for 2018. Catalyst Technologies grew sales 10% and earnings 8% in 2017. Demand for our premium FCC catalysts and propylene maximization technologies was solid and the ART joint venture had another good year, with strong demand for our clean fuels and resid upgrading technologies. Specialty Catalyst sales grew 18%, including 11% from the 2016 acquisition. We saw a strong demand for our high-performance CONSISTA non-phthalate polypropylene catalysts and for our LYNX products. We had a strong year in licensing lends and now have our strongest ever backlog of licensing revenue and pull through catalyst demand. Materials Technologies grew sales 3% for the year, including 7% growth in our silica business. As we enter 2018, we are seeing good demand across all of our businesses. Demand for plastics continues to grow faster than global GDP, crude prices continue to support good demand for petrochemical feedstocks and transportation fuels from FCC units, and GDP and disposable incomes are driving growth in silica applications, particularly, in coatings, industrial, and emissions control end uses.

In our Refining Technologies business, we expect demand growth to be in the low single digits, driven by demand for petrochemical feedstocks and transportation fuels. We expect refinery utilization rates to remain high, increasing the value of our high-performing catalysts. Several years ago, refiners began building and operating FCC units to produce petrochemical feedstocks, and we expect this strategy to grow in coming years, particularly, in the Middle East and Asia. One recently announced agreement is a case-in point. Our high-performing FCC catalysts will help our customer maximize propylene production for their downstream petrochemical assets. This is a long-term growth driver for us as customers adjust strategies to their changing demand environment. In the ART joint venture, we expect demand growth to be in the mid-single digits, driven by growing demand for clean fuels and tougher global fuels regulations. Our customers are investing heavily in new hydroprocessing units, and we are investing to increase catalyst capacity throughout our manufacturing network.

In Specialty Catalysts, we expect demand growth in the high single digits. A new polypropylene production investment cycle is beginning, as evidenced by the recent increase in licensing activity. We are well positioned for this cycle, given the clear strengths of our UNIPOL process and Catalyst Technologies. Since the start of this cycle, our win rates are up and the amount of newly licensed capacity is more than 3x the previous 5-year average. We'll benefit from higher licensing revenue over the next several years and from pull through catalyst sales for many years to come. In polyethylene catalysts, we are positioned to grow, as our customers invest and we add capacity and expand our portfolio. The planned acquisition is an important addition to our customer-value proposition, adding a high-value, fast-growing technology to our polyethylene catalyst portfolio. We are focused on integration planning and preparing for a Q1 close.

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We expect our Materials Technologies business to grow mid-single digits, with good growth in silica and pharma fine chemicals. Silica growth is driven by macro factors like growing disposable income in the emerging regions and changing regulation, and also by company-specific factors like accelerated innovation in our commercial and manufacturing excellent efforts. For example, we've seen good demand for our coatings products that allow customers to eliminate heavy metals from their formulations. We've also seen good demand in the mission control applications, where our technologies help our customers improve their products to meet tougher regulations. Growth in our pharma fine chemicals business is driven by demand for our onshore innovation capabilities. We have rebuilt our sales pipeline and expect this business to return to growth this year.

Let's turn from growth to manufacturing and supply chain. Last year, we incurred higher-than-expected manufacturing costs as plant utilizations quickly increased to deliver higher top line growth. After a tough first half, we made good progress, improving operations and reducing costs. We still have plenty of room to improve. We've made a number of leadership changes in operations over the last year, including one we announced this morning. Sam Mills has joined Grace as Vice President, Integrated Supply Chain. Sam comes to us with more than 2 decades of global manufacturing and supply chain leadership experience. I'm delighted to have Sam on our team and look forward to his leadership.

Inflation has clearly picked up since this time last year. We are seeing higher input costs in our businesses and throughout our industry. This makes the value proposition of Grace's products even stronger for our customers, whether they are trying to capture more value for their production or make their operations more efficient. It also puts pressure on our margins. We have initiated price increases across our businesses to capture our fair share of the value we create for our customers and to help offset these rising input costs. We expect to improve gross margins this year as improved manufacturing performance, productivity, improved pricing and other actions offset higher raw material costs. We have made good progress on our growth goals and 5-year financial framework. When we see you at Investor Day in a few weeks, we'll share more details of how we are positioning our company for continued sales growth, solid profitability and strong long-term returns.

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

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

Thank you, Hudson. Grace's fourth quarter sales were \$460 million, up 4% versus Q4 last year. For the year, sales were \$1.7 billion, up 7%. Adjusted EPS for the quarter was \$0.98 per diluted share, up 3% from last year. For the year, EPS was up 10% to \$3.40. Adjusted free cash flow for 2017 was \$274 million, up 16% versus last year. Adjusted EBIT of \$115 million was down 3% against a strong compare last year. Operating margin was 25%, down 200 basis points, reflecting higher manufacturing costs, including raw material inflation of 90 basis points and product mix. For the year, EBIT was \$414 million, up 3%. Our adjusted EBIT return on invested capital on a trailing 4-quarter basis was 24%, improving slightly from the end of last year.

With respect to taxes, in the fourth quarter, we recorded a provisional charge of \$143 million or \$2.10 per diluted share to reflect the estimated impacts of the new tax law. This included the U.S. tax on deemed repatriated earnings of non-U.S. subsidiaries, the write down of net U.S. deferred taxes to reflect the reduction in corporate tax rates and the effect of the implementation of the new territorial tax system. The impacts of the legislation may differ from the estimate, possibly materially. The amount of the provisional charge may be adjusted over the course of 2018 due to changes in our assumptions and interpretations, guidance that may be issued, and actions we may take.

Shifting to our business performance. Catalyst Technologies' sales for the quarter were up 5% versus last year on volume growth and currency benefit. Adjusted gross margin for the quarter was 42%, down 140 basis points from prior year due to higher manufacturing costs, including raw materials and product mix. On a sequential basis, adjusted gross margin was up 70 basis points, reflecting improved regional and product mix, partly offset by higher cost. Adjusted EBIT of \$109 million for the quarter was up 2% versus last year.

In Materials Technologies, sales for the quarter were up 3% versus last year primarily from silica volume growth of 8%, mostly offset by the decline in pharma fine chemicals volumes. Gross margins declined 360 basis points year-over-year, half of which was due to the pharma fine chemicals business, with the balance due to a higher manufacturing cost, including raw materials. Adjusted EBIT of \$25 million was down \$4 million over the year-ago period on lower gross profit. In 2017, we invested over \$140 million in capital expenditures. Of that amount, over \$50 million was directed at high-return growth and productivity projects. This spending is part of our multiyear investment program in response to strong demand for our products and will enable us to improve our cost position. In 2017, we returned 45% of adjusted free cash flow to shareholders, including \$65 million



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in share repurchase and \$57 million in dividends. Today, we announced a 14% increase in our quarterly dividend from \$0.21 per share to \$0.24 per share. The increase will be effective with the first quarter, with payment expected on March 22.

Let's pivot to 2018. I'll provide some context for our outlook before getting to the numbers. First, let's look at tax reform. The new law enables greater competitiveness through a lower U.S. tax rate, investment incentives and global mobility of cash. As a result, we are now able to use our strong balance sheet to more effectively fund our growth and to achieve our capital allocation priorities. We expect our adjusted ETR to be between 27% and 28% for 2018, down about 400 basis points from last year. This rate excludes incremental taxes that result from our existing U.S. net operating losses and is more representative of the company's ongoing tax rate after the NOLs are fully utilized in 2019. Under the new tax law, our favorable adjusted cash tax rate of 12% to 15% is extended 2 years to 2026, principally due to our foreign tax credits and lower U.S. tax rates. Second, is the anticipated acquisition. Our guidance includes earnings and cash flow of the acquired business based on a close date of March 31. It also reflects our preliminary estimate of purchase price allocation, depreciation and amortization expense as well as financing costs. Third is inflation. We're continuing to see inflation in raw material costs, principally in natural gas, caustic soda, aluminum derivatives and rare earths. As we announced last quarter, we are increasing prices in each of our businesses to capture the value we create for our customers and to also offset inflation. We're in the early innings of the pricing actions, and we're seeing good progress by our commercial teams. And one final point. We're evaluating the useful lives of our machinery and equipment. Our objective is to ensure that our financials reflect depreciation expense, consistent with the actual productive lives of these assets. We currently use a range estimate of 3 to 10 years for this category of assets, which we believe is shorter than the actual current useful lives. We expect the evaluation to be completed in the first quarter and to apply any change in estimate or as a change in estimate to our new and existing assets on a prospective basis, effective January 1.

With that, I'll pivot to our guidance, and then we'll open the call for your questions. We expect revenue growth of 8% to 10%, including a 4% benefit of the anticipated acquisition. Adjusted EPS in the range of \$3.72 to \$3.82 per share, up 9% to 12%. Adjusted EBIT in the range of \$440 million to \$450 million, up 6% to 9%. Adjusted free cash flow is expected to be between \$210 million and \$250 million. Our capital investments will increase to \$200 million, reflecting the step up of our growth and productivity investment program started last year.

Looking to our business segments. We expect Catalyst Technologies' earnings to be up high single digits for the year, driven by volume growth, margin improvement and the planned acquisition, partly offset by the compare against last year's business interruption insurance proceeds.

Specialty Catalysts will grow at a rate higher than FCC catalyst, given the growth in plastics demand. We expect good earnings in the -- in hydroprocessing through the ART joint venture on continued strong demand. Though catalyst refresh cycles in that business are expected to shift sales toward the second half of next year.

In Materials Technologies, we expect earnings to be up mid-single digits as our silicas business continues to grow, and we see improvement in pharma fine chemicals.

Turning to the first quarter. We expect to continue our year-over-year sales growth performance and adjusted EPS is expected to be up mid-single digits over last year.

In closing, we are focused on continuing to deliver top line growth, while expanding gross margins and 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, we'll open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Chris Parkinson with Crédit Suisse.



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

You previously discussed 7% core EPS growth as of 2Q '17, prior to the benefits of the ALB acquisition and lower effective tax rate. Can you just kindly comment on any key moving parts as of the second half, which may have shifted this view? Is there anything that we should consider in terms of product risk, raw material inflation, et cetera. Any guidance would we appreciated.

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

Thanks, Chris. This is Fred. This goes under the heading of "No good deed goes unpunished." But in all seriousness, if you look at it, as we looked at that, there was 3 components: There was the base business growth; there was a share buyback profile that we had planned that, obviously, changed once we signed the Albemarle deal; and there was some discrete tax actions that went away, given the tax reform act. Net-net, the base business is stronger today than it was when we made that proclamation, including the absorption of the higher inflation. So that's -- hopefully, that gives you a context of the pieces.

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

Great. And just a quick follow up. You've sent a lot of licensee contracts during the past few quarters, which in aggregate, should begin to add up over the coming year or 2. Can you just comment on what's embedded in your '18 guidance and give us a better sense of the near and intermediate term effect -- margin effects, understating some may be back end loaded?

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

Chris, this is Hudson. We signed 6 licensing contracts last year, most of them in the second half of the year. And we'll recognize revenue and earnings on those contracts over the next several years as the underlying work gets performed. Some of that work has started already. Some of it will start later in 2018. On average, that work is 3, maybe 4 years, couple of the contracts go a little bit longer. And so, you should think about layering in those benefits along those time frames. There's some contracts that expire, obviously, where work is being finished on licenses we sold over the last few years. The other thing that's important here is the long-term value that it creates for us with pull through catalyst sales. The licensing revenues themselves are valuable but the pull through catalyst sales are valuable for many, many years to come.

Operator

And our next question comes from Robert Koort from Goldman Sachs.

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

This is Chris Evans on for Bob. I was hoping you could give a little more of a gross margin bridge in the fourth quarter and maybe how that informs your guidance on price costs in your '18 guidance.

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

Sure, Chris. It's Hudson again. As we looked at fourth quarter, we had sequential improvement from Q3 to Q4. That reflects progress that we made in our manufacturing operations, progress that we made with product mix and it did not really -- back to the other Chris' first question, not really any benefit of the incremental licensing. When we look on a year-over-year basis, there's a lot of product mix and customer mix in that year-over-year number. We've got some lumpiness in our catalyst businesses, including ART. And there's a lot of year-over-year product and customer mix in that number.



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

And so then, Tom mentioned some of the raw materials that are working against you into '18. Just as you guys envision your pricing strategy, do you suspect your pricing will off -- more than offset any raw material headwinds?

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

It's a great question. We do expect -- over the course of 2018, we expect our pricing actions to offset the inflation we've seen so far. And -- but the timing will be different. The inflation really started in the second half of last year. We'll have more inflation in the first half of this year. The pricing will come back more in the second half of next year. So again, over the course of the year, we think it balances but the timing will be off a little bit.

Operator

And our next question comes from Kevin McCarthy from Vertical Research.

Kevin William McCarthy - Vertical Research Partners, LLC - Partner

I was wondering if you could drill down a little bit more on the subject of catalyst pricing. Your commentary suggests you're pursuing price quite broadly. Yet if we look at Slide 5, it appears as though the price contribution, perhaps including mix, trended negative in the quarter. So can you help us parse out what that mix effects might be and where you are more confident or less confident about gaining price going forward?

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

Kevin, it's Hudson. We -- in the FCC catalyst business and in the hydroprocessing catalyst business, we started off well in discussions with customers about making sure we're getting the full value for the catalyst technology that we're selling. We're in early innings on this, as Tom said. These announcements were made middle Q4, I think. And we expect to see steady progress as we go through 2018. When you look at last Q4 and do the year-over-year compare, there is a lot of customer and product mix in there. We lost some volume at some higher-value customers, as you all know. We replaced that volume during the year but not always at the same price and margin level. And we saw some mix shifts, not significant, but we did see some mix shifts in both SC catalysts and -- sorry, Specialty Catalysts and in Refining Catalysts.

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

Let me just help quantify or qualify. The lost piece Hudson's referring to, is a part of the -- our large customer. This hasn't -- that ran in the fourth quarter of '16 that did not run in the fourth quarter of '17. That's a big mix contributor on the price side.

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

Yes, thank you for that. That's exactly right.

Kevin William McCarthy - Vertical Research Partners, LLC - Partner

Understood. Thanks for that. And then second question relates to the Middle East, and perhaps, Asia as well. Maybe 2 parts. First, I think there are a number of refinery startups in those part of the world. Just wondering if you could comment on your outlook for new customer wins and then second part would be related to that, I think you've been targeting a new FCC plant in the Middle East. What is the status of that and how much might you be baking into the \$200 million CapEx forecast for 2018?



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

Kevin, Hudson again. We do expect to win our fair share -- at least our fair share of new refinery startups. One of the important things to think about is a lot of the FCC capacity, refining capacity, that's being built in the Middle East and Asia, is being built to produce petrochemical feedstocks as much as to produce transportation fuels. This is propylene to feed downstream petrochemical assets. A lot of these applications are taking low-value crudes all the way to high-value propylene, and our catalysts play very, very well there. It's an important growth opportunity for us in 2018 but for years to come as well. In terms of our investment in Abu Dhabi, we are doing engineering. We've done a little bit of dirt work in the region. And the final construction activities in the startup of that facility will be timed with the demand growth in that region. And that's our plan. We expect to be moving forward on that over the next few years.

Operator

And our next question comes from John Roberts from UBS.

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

Hudson, congratulations on the promotion -- for movement to the board. In fine chemicals, was it just a gap in the backlog of your former contracts that caused the decline that we have there? You didn't have any discontinued or exited products reported.

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

We did not. We had some delays. The biggest issue that we faced last year were delays relative to what we had expected. And it took us 6 or 9 months to adjust to that over the course of last year, especially in the second half of last year. We did some really good work with customers to rebuild our pipeline, and we're much better positioned heading into 2018.

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

And is there any update on the Takreer repairs and do they already have the catalyst for their restart or is that something that you still have to ship during 2018?

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

Yes, this is Fred. It's -- the repairs are progressing, as we've said this outlook -- it would've been consistent this outlook does not include any sales of catalyst to them. If it does come on earlier, they will need catalyst to restart the unit, obviously. So...

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

So your plan is for an early '19 shipment restart?

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

That's right. That's correct.



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Operator

And our next question comes from Chris Kapsch from Loop Capital Markets.

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

A couple of questions on the dividend increase 14%, arguably, above the, sort of, the base business growth trend. Is there any subtle message there with respect to capital allocation philosophy, especially given that you did come across this Albemarle catalyst acquisition and so may be less capacity available to allocate to shareholders.

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

Yes -- no. Chris, this is Fred. No, I mean, the dividend increase of 14% is consistent with the message that we said we are going to grow our dividends faster than we're going to grow our EPS earnings growth on that side of it. In the fourth quarter, we took a slight pause in our share buyback, as we relooked -- as we look at all the financing around Albemarle -- the Albemarle deal and so on. But our capital allocation framework is continued -- back on the same program that we put in place before. So you shouldn't read anything into that, anything different.

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

Okay. And just then just following up on prior question about the catalyst business and the pricing dynamic. I get that -- I guess, it was you first started shipping to Takreer in the fourth quarter of -- where you had the Takreer sales in the fourth quarter of '16 but not '17. So I get the drag there. But if you were to back that out, would the pricing mix be positive for the rest of the business?

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

Yes. If you adjust for those things, pricing was positive in FCC.

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

Okay. And then that leads into this, just more -- just thinking about the several of the drivers that you talked about for that industry. If you -- notwithstanding Takreer, obviously, but a number of units coming up and you pointed to a number of existing refineries adding FCC units in order to produce more petrochemical feeds downstream. So overall, the industry hasn't really added any FCC capacity, and yet, overall, the demand continues to increase, probably also bolstered by global crude slate mix that continues to skew, sour, heavy, which is more FCC catalyst intensive. So just wondering why the setup isn't for -- especially considering the inflation call-outs, why the setup isn't for it to be a lot easier to get more affirmative FCC pricing?

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

Chris, we've said we're in the early innings on this, and we've started good progress with our customers. We'll keep you all updated as the year goes on.

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

Okay. And could I just -- on the bridge that you point out in your deck, can -- FX is included in toward the base business of \$0.32 to \$0.37 in terms of the bridge on your EPS to the guide for '18. What is the assumption, just on the euro and how much of a contribution is FX?



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

So, Chris, it's Tom. So we're -- our estimates are around the euro/dollar. Are for a stronger euro in the first half of the year and a weaker euro in the second half of the year. We've got a range of estimates in that, it's hard to pin it to any particular impact right now as the range of outcomes and affects.

Operator

And our next question comes from Mike Harrison from Seaport Global Securities.

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

Just going back to the commentary on the polypropylene licensing deals you've announced. Appreciate the color on kind of the cadence longer term of that contribution that it's kind of a 3- to 4-year type of time horizon on average. But do we get to full contribution from the deals you've already announced by the end of 2018 or are some of them going to be ramping in 2019? And, I guess I just want to come back to -- of the \$440 million to \$450 million in EBIT for 2018. How much of that contribution is expected to come from the new polypropylene licensing deals?

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

For the most part, those contracts will all be at some stage of execution by the end of this year. There could be one exception but I don't think so. In terms of exactly how much is in our numbers for next year, I'm not going to quantify that for you. But it is part of the top line and earnings growth that we expect this year.

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

All right. And then, was also hoping that in terms of the FCC business, you would announce a couple of new wins last year. It sounds like you had another new FCC max propylene customer win already this year or maybe it was during the fourth quarter. But can -- as we think about how they could contribute to offsetting that \$25 million insurance proceed hole that you have. Can you point us to how much additional FCC business you've gotten up to this point? And are you -- I mean, are you comfortable you can offset about half of that \$25 million? Is it more or less than that? How should we think about it?

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

We expect top line growth in the FCC business this year. We expect earnings growth in the FCC business this year. That's a combination of volume growth with existing customers. It's a combination of new customer wins. We've got a good pipeline right now on new customer wins. Things that happen in the middle of the P&L, we do experience inflation in that business. But we've got productivity and pricing actions as we've discussed. So all of those things work together to give us a top line in earnings growth profile for RT this year.

Operator

And our next question comes from Tyler Frank from William Baird.



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Tyler Charles Frank - *Robert W. Baird & Co. Incorporated, Research Division - Associate*

Can you discuss your appetite for further acquisitions at this point, and maybe give us some color on potential acquisitions, just on the size you might be considering. Are they smaller suck ins or can we expect a larger acquisitions in the near term?

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

Yes, this is Fred. I mean, we're looking at a number of bolt-on type acquisitions, both across catalyst as well as the materials side of it. And after we -- we'll obviously digest the Albemarle and finance that and maybe Tom you can give an update on how you feel the financing is coming on that side of business.

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

Yes, I think the financing is going well. We'll have more report at the end of first quarter. But we feel comfortable with where the net leverage is as a consequence of getting that deal done and earnings or potential of that business. And so we feel good about our ability to continue over some period of time looking at the bolt on things that Fred was talking about.

Operator

And our last question comes from Laurence Alexander with Jefferies.

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

Two quick questions. One, the 8% volume growth in silicas. Can you give us a feel for your neutralization rates or how CapEx may need to shift for that business? And secondly, can you help us a little bit think about the longer-term pull through, I think you called it, for -- as you get the licensing deals then you get the catalyst sales as a run rate with a bit of lag. Given the number of licensing deals you have on the -- in the near term horizon, is it fair to think about that as being a 1% to 1.5% lift to the catalyst segment sales CAGR in the 2020, 2025 period? Or is that too ambitious?

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

Laurence, it's Hudson. I'll start with your MT question. We've seen good demand growth in our -- in the silica business, really for the last 5 or 6 quarters now. The plants are running -- full at this point. We do have an investment strategy -- I'm sorry, we do have an investment strategy that is adding capacity to MT, and I'll take this as an opportunity. We do have a higher CapEx guidance for this year. We are adding capacity in our MT business to your specific question. We are adding capacity in our Specialty Catalysts business to supply the growth that we're seeing there. I think I commented in the script on the investments that we're making in our hydroprocessing manufacturing capacity. And even in FCC, we're adding capacity to supply the high-performing catalysts, the newest technology that we have. So that's a broad theme for us as we've seen our growth rates tick up, adding capacity across our network. And now that I've said that, I forgot your second question, Laurence?

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

So just the pull through from the licensing deals into actual catalyst demand, what that means for longer-term sales CAGR if we can think about that as an extra contributor?

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

Thank you. So the global demand for plastics grows 4% to 5%. And polypropylene and polyethylene are in that range. They've been among the stronger-growing types of raisins over the last decade, probably. As we look forward, we expect our Specialty Catalysts business to grow faster



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than that. Probably, a couple of percentage points faster. As our customers invest, as we invest, as we gain share of wallet on the strength of our technologies. And I think that's a long-term outlook for us. I think maybe one more comment I'll make. Several of the questions have touched on licensing. We have a long visibility to licenses. We see them multiple quarters before they get finalized and announced. So the licensing successes that we saw in the second half was in our thinking for really all of 2017. And we don't always get the timing right but seeing them in our backlog has been part of our thinking for a long time now.

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

So I guess, I just have to ask then, given you have the long visibility, any bumps in the road or tough comp issues in '18, '19, '20 on that front?

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

Specifically, because of licensing? Not really, because the way we recognize the revenue and earnings, it gets smooth over time. The cash flows come in lumps but the revenue and earnings get smoothed over the life of the -- not the licensed period, but the upfront period when the engineering work is being done.

Operator

And we have a follow-up question from Mike Harrison from Seaport Global Securities.

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

Just one more on the ART joint venture that was quite a bit lower year-on-year. Can you help us understand what was going on there? And I know you mentioned in terms of guidance the expectation that you grow mid-single-digit for 2018. I think you also mentioned that it would be more back half weighted. Just maybe some additional color on ART?

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

Sure. A couple of thoughts. The ART had a record year in 2016 and so we had a tougher compare last year. The demand growth was good. The margins were higher in ART in '17 versus '16. Our team has done a nice job expanding margins there. There were some things that happened below the gross margin line that were a headwind. That reverses as we head into '18. And we should see top line growth, margin expansion and earnings growth in ART in '18.

Operator

And I'm showing no further questions in the queue at this time. I'd like to turn the call back over to Tania Almond for any further questions.

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

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

Operator

Ladies and gentlemen, this does conclude your program, and you may all disconnect. Everyone, have a great day.



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