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GRA - Q1 2014 W. R. Grace & Co. Earnings Conference Call

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OVERVIEW:

Co. reported 1Q14 sales of $745m, and adjusted EPS of $0.77.

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CORPORATE PARTICIPANTS

Mark Sutherland *W. R. Grace & Co. - VP of IR*

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

Hudson La Force *W. R. Grace & Co. - SVP & CFO*

CONFERENCE CALL PARTICIPANTS

Brian Maguire *Goldman Sachs - Analyst*

Mike Ritzenthaler *Piper Jaffray & Co. - Analyst*

Robert Walker *Jefferies & Company - Analyst*

Ben Kallo *Robert W. Baird & Company, Inc. - Analyst*

Dmitry Silversteyn *Longbow Research - Analyst*

Jim Barrett *CL King & Associates - Analyst*

Ernie Ortiz *Credit Suisse - Analyst*

Chris Shaw *Monness, Crespi, Hardt & Co. - Analyst*

Mike Sison *KeyBanc Capital Markets - Analyst*

PRESENTATION

Operator

A very good day to you, ladies and gentlemen, and welcome to your W.R. Grace & Co. first-quarter 2014 earnings conference call hosted by Mark Sutherland, Vice President of Investor Relations. My name is Chris and I will be your conference coordinator today.

(Operator Instructions). Thank you. At this time, I would like to turn the call over to Mr. Mark Sutherland to begin. Please go ahead.

Mark Sutherland *- W. R. Grace & Co. - VP of IR*

Thank you, Chris, and hello, everyone, and thank you for joining us today, April 23, 2014 for a discussion of Grace's first-quarter 2014 results released this morning.

Joining me on today's call our Fred Festa, Grace's Chairman and Chief Executive Officer; and Hudson La Force, our Senior Vice President and Chief Financial Officer.

Our earnings release and the corresponding presentation are available on our website. To download copies, go to Grace.com and click on Investor Information. A link to the slide deck is available under the events navigation tab.

As you know, some of our comments today will be forward-looking and are made under the Private Securities Litigation Reform Act of 1995. 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 also discuss certain non-GAAP financial measures, which are discussed in more detail in this morning's 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 on our website. Our comments on forward-looking statements and non-GAAP financial measures apply both to the prepared remarks and to the Q&A.

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And with that, I will turn the call over to Fred.

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

Good. Thanks, Mark, and hello to everyone and thank you for joining us this morning.

I'm pleased that we have started the year with increased sales volumes in all three segments. Catalysts Technologies sales volumes increased 10%; Materials Technologies increased 2%; and our Construction Products increased 8%.

The sales improvement was balanced across all geographic regions. Sales in advanced and emerging regions each increased 8% year over year before the impact of currency translation and rare earth surcharges. We saw significant currency impacts during the quarter, especially in Materials Technologies and Construction Products. These currency impacts reduced reported emerging region sales by 6%.

As we disclosed in March, extreme cold weather in North America took a bite out of our sales and earnings. Overall, we estimate that weather impacted earnings by $9 million with 2/3 from higher operating costs and 1/3 from lost sales.

Our Curtis Bay plant, located in the Baltimore harbor, was closed for part of 13 days. Curtis Bay is one of the largest plants and is a shared production site for Catalysts and Materials Technologies.

In addition to lost manufacturing time, we also incurred higher utility and logistics costs. Lost sales were primarily in Construction Products, where construction activity was slowed or delayed.

Let's take a look at our first-quarter highlights, and we will start with Catalysts Technologies.

We continue to be very pleased with the UNIPOL polypropylene licensing and catalysts acquisition. In addition to $28 million of top-line contribution in the quarter, the acquisition contributed about $3 million to segment operating income after acquisition-related costs of about $7 million. The business is on track to deliver our plan of about $30 million in operating income this year, including synergies of about $10 million, slightly favorable to our acquisition model.

The integration tasks have been completed two months ahead of schedule, and the majority of transition service agreements will conclude at the end of this month.

In addition to the UNIPOL growth, we expect growth of about 5% in our legacy polyolefin catalyst business this year, driven by growth in plastics end-use demand and new business wins. In Q1 sales volumes in this part of our business were down due to a scheduled conclusion of a toll manufacturing agreement last year and an inventory adjustment at one of our larger customers.

In our FCC business, volumes increased year over year, but pricing was down, largely due to the rare earth surcharge and some base pricing, as well. The commercialization of our new FCC Catalysts Technologies is on track.

Looking at FCC market conditions, we continue to project a solid overall picture for refinery catalyst demand. Global FCC demand is projected to be up 4% this year with global demand for gasoline up 2%, largely in emerging regions and demand for propylene and new FCC unit startups adding another 2 points.

US refineries are seeing strong utilization rates approaching 90% and our cost advantage with shale oil feedstocks. However, utilization rates for European refineries have dropped below 80% due to lower domestic demand and competition from imported fuels. We saw weak demand in Europe in Q1 and expect some weakness to continue through the year. This is putting some pressure on refining catalyst sales volumes and margins.

Materials Technologies had a solid quarter. In addition to better top-line growth, gross margin was steady at 35% and operating margin was closing in on 21%. The engineered materials product line saw strong year-on-year growth at 7% with especially strong growth in Western Europe. This is an encouraging trend, given this product line's correlation to industrial production.

Packaging technologies had a tougher quarter with slowing end market growth and volatile currencies in the emerging regions. Despite these top-line pressures, margins are at the planned levels.

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At our Investor Day in March, we highlight our Discovery Science product line, which is focused on developing silica-based products for the pharmaceutical industry. Last month at key conferences in the US and Europe, we launched our new ProVance products, a portfolio of novel technologies for cost effective purification of biologic drugs. ProVance is a great example of our ability to leverage our expertise in silica chemistry and manufacturing to grow sales and improve margins in high value and faster-growing market segments. Our Materials Technologies segment is a strong franchise with a rich pipeline of silica-based products and technologies currently under development.

In our Construction Products segment, we saw good growth in the quarter for both Specialty Construction Chemicals and Specialty Building Materials despite weather-related impact on US sales. We estimate the adverse weather resulted in at least $4 million of lost sales at above-average margins. Contractor capacity and labor constraints may limit our ability to recover these sales, which would reduce full-year growth rate in the US by about 1 point.

In Western Europe, we saw good year-on-year growth, driven by favorable weather and strong project starts. We may be coming off the bottom in Europe and now expect some growth in Western Europe this year.

In the US, we are encouraged with signs of continued recovery in commercial construction spending. One example in February, Grace products were part of a record-breaking concrete pour in Los Angeles. The 21,000 cubic yard pour, more than 2,000 truckloads, was the foundation for the $1 billion new Wilshire Grand, a hotel, office and convention center complex. With 73 stories and five levels of underground parking, this will be the tallest building west of the Mississippi.

In closing, our view of the remainder of the year is balanced. Despite some first-half headwinds, we have identified a path to achieve our target results for the year. I'm confident that our track record of performance will continue as we strive to meet our goals for growth, margins, cash flow, and return on invested capital.

With that, I will turn the call over to Hudson for more specifics on the quarter.

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

Thank you, Fred. Please turn to pages 4 and 5, and we will start with a quick review of Grace's overall results for the quarter.

Sales were $745 million, an increase of 5% from last year. Sales volumes increased 7%, including an increase of about 4% from acquisitions. Higher base pricing of less than 1% was more than offset by lower rare earth surcharge pricing of about 1%. We stopped the surcharge pricing mechanism in early Q2 2013 when rare earth costs stabilized.

Segment gross margin was 36.3%, a decline of 90 basis points compared with last year, primarily due to costs associated with the adverse weather in the US and higher costs in our Construction Products segment associated with our concrete chemical process control technology.

Adjusted EBIT was $111 million, down 5% from last year and including $9 million of weather-related costs; $7 million of acquisition-related costs; and $5 million in unfavorable currency, which more than offset the benefit of higher sales volumes. Excluding the weather and acquisition-related impacts, adjusted EBIT would have been flat with last year.

Adjusted EBIT margin decreased 160 basis points to 14.9% and adjusted EBITDA margin decreased 130 basis points to 19.5%. The weather and acquisition-related costs reduced adjusted EBIT and EBITDA margins by more than 200 basis points.

Adjusted free cash flow was $65 million for the quarter, in line with a year ago and in line with our operating plan. Adjusted EBIT ROIC was approximately 27% and adjusted EPS was $0.77 on diluted shares of 78.1 million.

Let's turn to Catalysts Technologies on page 6.

First-quarter sales for Catalysts Technologies were $285 million, up 7% from last year. Sales volumes increased 10%. FCC catalysts sales volumes increased 2% and the polypropylene catalysts acquisition contributed 10%. As Fred mentioned, specialty catalyst sales volumes were lower, primarily due to the conclusion of a multi-year toll manufacturing contract for a polyolefin catalyst customer last year. We will lap this contract loss in Q2.

Currency translation was 1% favorable to sales, while pricing declines 4%, mostly due to lower rare earth surcharge pricing.

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Catalysts Technologies gross margin was 39% for the year, down from 40.3% in the prior-year quarter. Weather-related costs reduced gross margin by almost 200 basis points.

Segment operating income was $71 million, down from $77 million last year. The UNIPOL polypropylene acquisition was positive to operating income in the quarter, contributing $3 million to segment operating income after acquisition-related costs of $7 million.

Segment operating margin was 25% compared with 29% in the prior-year quarter, reflecting the lower gross margin, acquisition-related costs, and lower ART earnings.

We are making good progress in returning to our historical refinery catalyst market position through the introduction of new FCC catalyst technologies. These products are on track to represent about 10% of our FCC catalyst sales for the year with about half representing new business and half replacement business.

Although the US, Middle East, and South Asian refinery markets are strong, we do see weaker refinery operating environments in Europe and China. Grace is the largest FCC catalyst supplier in Europe and refining market challenges in that region may impact us over the course of the year.

In China, we have seen a shift in refining utilization toward the state-owned majors and away from the independent refiners that are our natural customer base.

Our share of ART's net income was $3.7 million, down about $1 million from last year due to unfavorable product mix and higher manufacturing costs. Market dynamics for HPC catalysts remain strong. However, we've seen a shift in our ART business over the last few months. We are seeing a less favorable sales mix, higher manufacturing costs, and higher market development costs. We will be able to offset some but not all of these headwinds with productivity initiatives and cost reduction programs this year.

For Q2, we now expect to our share of ART net income to be about flat to Q1, down from $9 million in the 2013 second quarter, ART's strongest quarter of that year.

Looking forward, we continue to expect strong sequential improvement in our catalyst results with Q2 earnings growing double digits from Q1. However, Q2 catalyst segment earnings are likely to be down year over year due to the weaker European catalyst demand and the shift in ART earnings.

For the full year, we expect low double-digit growth for segment sales and earnings compared with 2013. Full-year operating margin should be in line with the 2013 operating margin.

Let's move to Materials Technologies on page 7. First-quarter sales for Materials Technologies were $220 million, an increase of 2% from last year. Higher sales volumes of 2% and improved pricing of approximately 1% partially were offset by 1% unfavorable currency translation. Sales of engineered materials increased 7% year over year due to a 5% increase in sales volumes and 1% improvement in pricing. Sales in advanced regions grew approximately 10% and sales in emerging regions increased 2%. We saw very strong growth in Western Europe, which represented approximately 40% of product line sales. Coatings and industrial applications are driving the growth in engineered materials sales volumes.

Sales of packaging products declined as unfavorable currency translation of 3% and lower sales volumes of 1% more than offset a 1% improvement in price.

Materials Technologies gross margin was 34.9%, down 20 basis points due to unfavorable currency and weather-related operating costs.

Segment operating income increased approximately 3% to $45.5 million, primarily due to higher sales and improved operating leverage. Segment operating margin was 20.7%, up 10 basis points from the prior-year quarter.

Materials Technologies has operated in Venezuela for decades with sales in that country of about 2% of segment sales in 2013. In Q1, we began seeing a significant impact to our sales and earnings in Venezuela. Over the past few months, it has become increasingly difficult for us and our customers to operate normally in the country. If we or our customers are unable to resume normal operations, we will experience further reductions to our sales and earnings. We have about $2 million to $4 million of earnings at risk for the balance of the year. We will keep you updated as the year continues.

Please turn to page 8 for Construction Products. First-quarter sales for Construction Products increased 5% year over year to $240 million on strong volume growth of 8% and improved pricing of 2%, which offset 5% unfavorable currency translation. Adverse weather in the US had a significant impact on sales in the quarter. We estimate that extreme cold weather lowered sales by at least $4 million. Due to time and contractor capacity constraints, only a portion of these sales may be recoverable in subsequent quarters.

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Sales of Specialty Construction Chemicals increased 5% year over year, led by 13% growth in Western Europe and 9% growth in the emerging regions. Sales in the US declined 3%. The strong growth in Western Europe was attributable to favorable weather and increased project starts. With another consecutive quarter of positive results for Europe, market conditions appear to be bottoming.

Sales of Specialty Building Materials increased 5% as sales growth of 17% in Western Europe more than offset sales declines of 4% in both the US and emerging regions.

Segment gross margin declined 110 basis points to 34.4%, primarily due to higher operating costs associated with our Verifi construction chemical process control technology.

Segment operating income increased 11% to $25 million due to higher sales volumes, improved pricing, and lower operating expenses that more than offset higher raw material and manufacturing costs and unfavorable currency. Segment operating margin improved 60 basis points year over year to 10.6%.

Like Materials Technologies, Construction Products has operated in Venezuela for many years and is facing similar operating challenges in that country. Sales in Venezuela were about 2% of segment sales in 2013.

For our construction segment as a whole, we see a relatively favorable environment for the balance of the year. We expect North America to grow in the 5% to 6% range. Although it is a bit early to fully assess the strength of North American construction spending this year, improved cement and concrete prices and good demand in April are positive leading indicators.

In Europe, we could see growth for the balance of the year, driven by activity in Germany, the UK, and Turkey. Excluding currency effects, we expect high-single-digit to low-double-digit growth in Latin America and developing Asia.

Let me touch on a few corporate items and then we will take your questions.

Our full-year earnings outlook is unchanged. As we have highlighted in our remarks this morning, we see pluses and minuses as we assess the full year. Today we're operating below the midpoint of our range due to the Q1 weather impacts, demand uncertainty and FCC catalysts in Europe, and weaker ART earnings, but we're also looking hard at productivity opportunities across the Company. Based on this, our earnings pattern for the year will be a bit more back-half loaded than we thought in February.

Adjusted free cash flow was $65 million for Q1, in line with the prior-year quarter and our operating plan. CapEx was approximately $40 million, also in line with our plan. We continue to target at least $400 million in adjusted free cash flow for the year.

Cash on the balance sheet at March 31 was $420 million with net debt of approximately $1.7 billion. Assuming the midpoint of our outlook, net debt to adjusted EBITDA is approximately 2.2 times.

We spent about $60 million on share repurchase in Q1. And through yesterday, we have spent about $110 million to repurchase about 1.1 million shares.

We continue to view our business fundamentals as solid. We have great business franchises with strong growth opportunities, exceptional margins, high cash flow, and high returns on capital. We're managing for the long term and creating value for our customers and you, every day.

With that, we will open the call for your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). Brian Maguire, Goldman Sachs.

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Brian Maguire - ***Goldman Sachs - Analyst***

Hudson, you mentioned you are currently running a little bit below the midpoint of the guidance range due to some of the weather issues and a little bit weaker European refining. I'm just a little bit intrigued by the productivity initiatives you're talking about.

Are these things that you can implement quick enough to actually make up for some of the first-half challenges such that you could still get above the midpoint of the guidance range? Or is this sort of a soft cut to the guidance number for the year?

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

These are things I think that we can do fairly quickly, Brian, although I think that means Q3 and Q4. And that is -- as we look at our first half/second half balance, we are a little, like a couple of percentage points shifting from the first half to the second half relative to what we thought in February.

Brian Maguire - ***Goldman Sachs - Analyst***

Okay. And then just within catalyst, just looking at the base pricing it looks like that was down a little bit, similar to maybe what we saw in the fourth quarter. Just wondering if that is just a mix impact again. And between the FCC and the specialty business, are you seeing base pricing growing in one business or the other or are they both equally down at this point?

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

Brian, this is Fred. In the specialty side, we're actually seeing prices go up. And we've got some visibility on that both on -- as some of the new products come on as well as some of the new contracts.

On the FCC side, it is a combination of a mix of business from a shift to different regions, plus as we introduce some of our new trial volumes and so on, those are at trial-type pricing.

Brian Maguire - ***Goldman Sachs - Analyst***

And one of your competitors on that trialing had mentioned that they were seeing a little bit of increased trialing of their competitors; probably assumed that some of that is yours. They sounded a little bit confident that they were going to get some of them back. Just curious, with the FCC volumes up 2% in the quarter, how confident you are in that sticking and maybe even accelerating as the year goes on versus just maybe benefiting from trialing that may roll off in the second quarter?

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

Yes, I would characterize it as this -- if I look at our first half of 2014, we're feeling some of the impact of the European refineries. We have the biggest, largest position there, and we are feeling that piece of it.

We are fairly confident that our second-half FCC volume will be up high single digits over our first half, based on the adoption of the new products that we have, as well as some new units that we are seeing, as well as demand. So I hope that answers it.

Brian Maguire - ***Goldman Sachs - Analyst***

Thanks very much.

Operator

Mike Ritzenthaler, Piper Jaffray.

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Mike Ritzenthaler - ***Piper Jaffray & Co. - Analyst***

Wondering about the pace of earnings, I guess as a follow-up to Brian's question, specifically within catalysts. Historically, we have seen quarters one and four stronger volumetrically, but it sounds like it might be a bit more U-shaped this year, kind of like that has been in the past. Is that fair to say?

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

Yes, we think that -- I don't know about U-shaped, but our visibility says the third and the fourth quarter will be stronger than definitely the second.

Mike Ritzenthaler - ***Piper Jaffray & Co. - Analyst***

And could you remind us what the -- I can't remember if you have broken this out in the past -- but your top-line exposure to European refining within that segment?

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

Across FCC, it's our second largest. And about 30%.

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

25% or 30%, I would say.

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

25% to 30%.

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

25% to 30%, Mike.

Mike Ritzenthaler - ***Piper Jaffray & Co. - Analyst***

Okay, that helps. And then about your strength geographically, particularly in emerging markets, with things like macro data points, emerging market exposure comes in and out of vogue, on the street, at least. And I'm just curious about what, if anything, you are having your local managers do to weather volatility in end markets. And I guess specifically excluding Venezuela; that is a bit of a nuanced position. But I'm looking more at Latin America and China, I guess.

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

Yes, Latin America, other than Venezuela, we're seeing some underlying inflation in the raw materials. So for our local guys it is getting ahead of that in our pricing. And for us primarily in construction, as well as Materials Technologies, we've done a nice job on that side of it.

In emerging regions around Asia it is a little bit of a different balance in construction. We want to get in these projects, gets specked in and so on. So our people are working very hard on what are the top projects that will go and trying to resource it that way.

From a productivity standpoint in those plants in the emerging regions, we are working the actions to maintain our costs down and looking at our costs to poor quality, or looking at our operational efficiencies to make sure that we've got the right cost structure.

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Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

Mike, one thing I would add to Fred's comments, we are a small enough company that those local leaders aren't that far away from us in terms of communication lines and responsiveness. And if they need help from regional or central leadership, they get that pretty darn quick.

Mike Ritzenthaler - ***Piper Jaffray & Co. - Analyst***

That makes sense. Thanks guys, very much.

Operator

Robert Walker, Jefferies.

Robert Walker - ***Jefferies & Company - Analyst***

If half the new product volume, 10% of your volume is going to be new customers and your base business is probably growing 4%, is it fair to say you are expecting about 9% FCC volume growth this year?

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

That sounds a little high, Rob. The base business is still a competitive business, and accounts do move back and forth on the based business, as well. We give you that statistic just to give you all a sense of the progress we're making with those specific technologies, not specifically for the overall FCC catalysts business.

Robert Walker - ***Jefferies & Company - Analyst***

And can you talk a bit more about what has changed at ART and whether you expect profits to grow in 2014?

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

Yes, I would chalk it up -- if you look at it, half of it is reduction of some higher operating costs. We have had some operating issues during the first quarter across a couple of our plants. It has forced us to go outside and toll some product at some of our joint-venture partners that has higher input as well as costs moving back and forth.

In addition, we have not got the commercial success of a new product that we launched last year, and we have had some development costs around that. So we've got a mix of things happening across the ART segment including some of the product mix. Product mix being if we are selling a product in China versus selling a product in the Middle East or so on.

So a lot of dynamics working. The group is looking at it; the team is looking at it together with our venture partners; how can we optimize this and go on and move this business forward?

I mean we like -- let me make sure I am clear. The fundamental market demands in the hydroprocessing business are good. The market conditions are good. The industry is good. We like the alliance that we have done on the hydrocracking side; that has been paying good benefits, as well.

Robert Walker - ***Jefferies & Company - Analyst***

All right, thank you.

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Operator

Ben Kallo, Robert Baird.

Ben Kallo - ***Robert W. Baird & Company, Inc. - Analyst***

We saw the ABI index soften in March. Can you just walk us through -- I know that's just one part of your business, a read-through there, but just walk us through what you guys are actually seeing in the marketplace and if there is a disconnect there?

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

One data point on a moderately volatile beta series, we're not going to be able to correlate what we're seeing day to day with that. But I will say, Ben, by the end of March, the last week or two of March, the first -- I guess we've got about three weeks of April now, we've seen pretty good demand in North America.

So when we look back over, going back to January, we are pretty clear in our minds that we had a big weather impact, but coming on the back of that, it looks like we are back on track for the growth rate we thought we would get in North America.

Ben Kallo - ***Robert W. Baird & Company, Inc. - Analyst***

Okay, great. Thank you very much.

Operator

Dmitry Silversteyn, Longbow Research.

Dmitry Silversteyn - ***Longbow Research - Analyst***

I would like to follow up on a couple of questions. Number one, in FCC, you mentioned, in Europe, not just the lower utilization rates by the European refineries but you also talked about import pressures. Can you give us a little bit more color on where that pressure is coming from? Is it new entrants, is it existing entrants getting more competitive in search of market share? Can you talk about the dynamic of European import situation?

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

Yes, I think it is coming from a combination. I think it is coming from the wonderful position in the US from the shale oil position that's there, as well as some from the Middle East.

What it is doing, in the end, it will be a positive as it is forcing the refineries in Europe to look at, from a cost competitive, how can they be as competitive as they possibly can? And as I said, I think in the end it is a good thing. Is it putting some pressure on us today? Yes, it is.

Dmitry Silversteyn - ***Longbow Research - Analyst***

Okay. So the imports are more on the actual petrochemical side and the oil side, not in the FCC catalysts side?

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

Oh, okay, yes, I'm sorry. Okay, I understand. Yes, it's unfinished product coming in.

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Dmitry Silversteyn - ***Longbow Research - Analyst***

Okay --

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

So our customers are -- right.

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

Sorry if we weren't clear. It is not catalysts; it is our customers. Sorry, Dmitry.

Dmitry Silversteyn - ***Longbow Research - Analyst***

All right, thank you. Secondly, I just want to make sure I understand what you said about the mix shift in ART. It sounds like it is more geographic and where the growth is coming from currently rather than individual products, for example, affecting your mix. Is that correct?

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

Yes, that is the larger percentage of it. When we look at where these products are being sold, and what regions and what that customer demand and what that customer profile requires.

Dmitry Silversteyn - ***Longbow Research - Analyst***

Okay. So is this a situation where given that most new refineries and the increasingly stringent emission regulations are happening in Asia and to a lesser extent, Latin America, that that growth is going to exceed the growth of established markets for a while? So this mix shift and mix impact can be something that stays with you for more than a couple of quarters? Could this be a two- to three-year trend?

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

Yes, we don't think it is a two- to three-year trend. We think it is a couple of quarters. We look at that demand profile out there for what is being put in for clean fuels and so on. And as we look out it is going to require new catalyst capacity. When is the question. Is it 16 or is it 18, is the question. Right now we're getting whipsawed in that side of it. But that demand looks good. The licenses that are being sold on the clean fuels side of it and the bills that are happening, are happening.

Dmitry Silversteyn - ***Longbow Research - Analyst***

Okay, okay. And then just to follow up on the packaging weakness that you saw in your materials business, was that something specifically due to weather or a particular region? Or what is driving -- because I am looking at some of the [cam] companies and some of the other companies related into the packaging business, and they have actually had a fairly decent first quarter.

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

Yes, I will be perfectly candid with you. We are not sure. Because we had a pickup that came back in the April time frame. So is it our customer specifics on the can side of it? Is it geographic mix? We are not sure. As I said, we have seen the pickup come back on that side, so we're just cautiously watching it.

Dmitry Silversteyn - ***Longbow Research - Analyst***

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Got it. Okay, thank you very much.

Operator

Jim Barrett, CL King & Associates.

Jim Barrett *- CL King & Associates - Analyst*

Fred, one question for you and then one for Hudson.

Fred, the capacity of the roofing contractor side, given the severity of the winter, are you seeing or do you anticipate above-average demand for your roofing products in 2014 and beyond?

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

Yes, we do. The harsh winter, every time this happens, there is -- it is generally a delay -- that delay from when the winter is generally six months.

And what also, as you know, you have been around this business long enough, what complicates it is, can they have enough roofing contractors and everything to get it in between when the season gets bad again in the fall and how early that happens.

But fundamentally, it's just a matter of time. We feel very good about that position, and we feel very good about the commercial building materials side, as well.

Jim Barrett *- CL King & Associates - Analyst*

And is that a product line where you are in a position now to take pricing up in 2014 because of that?

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

We will test the market as we always do. We have introduced a nice new product in that building material called the pre-proof plus line that has gotten some very good adoption, especially in the commercial -- well, it is on the commercial side only.

Hudson La Force *- W. R. Grace & Co. - SVP & CFO*

We will get a good mix benefit even if we don't raise underlying prices, because of the strength of this pre-proof plus.

Jim Barrett *- CL King & Associates - Analyst*

I see. And then, Hudson, I think this is a question for you. The UNIPOL acquisition, $28 million of sales; $3 million of adjusted EBIT; plus $7 million of integration expense. When the integration expenses do peter out, is the quarterly sales rate and the adjusted operating results, is that a reasonable going-forward sales number -- quarterly sales number and quarterly operating profit number?

Hudson La Force *- W. R. Grace & Co. - SVP & CFO*

The answer is yes, Jim. This business does have a little lumpiness because of the licensing, the timing of licenses and things like that, but I think broad strokes, the answer is yes.

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Jim Barrett *- CL King & Associates - Analyst*

Well, thank you both.

Operator

John McNulty, Credit Suisse.

Ernie Ortiz *- Credit Suisse - Analyst*

This is actually Ernie Ortiz filling in for John. Just on the back of that question, so you have had the UNIPOL assets for almost half a year now. Are they performing well relative to your expectations? And are all of the financial targets the same in terms of capital [avoidance] et cetera, as when you originally laid them out?

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

Yes is the answer. We have had it -- operating it for four months. And the synergies that were forecast have basically been implemented, both on the existing business as well as the UNIPOL side. So yes, we feel very good about it. We feel very good about it. And the complementary nature with the rest of our polypropylene business is very good.

Ernie Ortiz *- Credit Suisse - Analyst*

Okay, that is helpful. And as a follow-up, you called out higher raw materials in the construction segment during the quarter. Can you just give us a sense as to how raws trended throughout the quarter across the business and just your sense on how they are going to trend for the remainder of the year?

Hudson La Force *- W. R. Grace & Co. - SVP & CFO*

Just for construction?

Ernie Ortiz *- Credit Suisse - Analyst*

I guess for the business as a whole.

Hudson La Force *- W. R. Grace & Co. - SVP & CFO*

Yes; well, let me do the construction piece and then I will give you the Grace overall.

Raws are up. A lot of this is raw material price increases we saw in the second half of last year that are now flowing through on a year-over-year basis. As we look from Q1 through the end of this year, we see a little bit of additional inflation, but not much -- sequentially as we go from Q1 to Q2 to Q3 to Q4. And now actually, already as I have said that for construction, I think that pattern actually holds for the whole Company as well; a little bit of inflation in Q1, but most of that followed through from last year. And as we look forward in aggregate, not much.

We were a little nervous about butadiene pricing a few months ago. That market has not -- those costs haven't increased the way we thought. Natural gas has moved around on us a little bit, but it is about -- it is consistent with what we thought it would be at this point.

Ernie Ortiz *- Credit Suisse - Analyst*

Okay, great. Thanks for the color.

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Operator

Chris Shaw, Monness.

Chris Shaw - ***Monness, Crespi, Hardt & Co. - Analyst***

I just have a quick one on Construction Products. You called out the lower gross margin as somewhat of a product of the higher operating costs for Verifi. Is that a new product launch that is going on there? Is that sort of one time or is that sort of just continuing higher costs for those products?

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

This is a new product development. This is the on board on the truck chemical dispensing unit. And we have been investing in it. We've been investing in it for probably the last two years now. And as we look at that investment trended up in the first quarter.

Chris Shaw - ***Monness, Crespi, Hardt & Co. - Analyst***

Will it continue for the rest of the year at those kind of levels, or is it --?

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

We're looking at it; we are assessing it; we're looking at the commercial -- how many commercial units we have and so on. We will give more color on that in the second quarter.

Chris Shaw - ***Monness, Crespi, Hardt & Co. - Analyst***

Okay. Thanks, that's it.

Operator

Mike Sison, KeyBanc.

Mike Sison - ***KeyBanc Capital Markets - Analyst***

Nice quarter. In terms of acquisitions, UNIPOL is going well, but there's another nice catalyst asset out there that is up for sale. And are there opportunities out there that you can leverage your balance sheet? Is that an area that you are focused on?

Hudson La Force - ***W. R. Grace & Co. - SVP & CFO***

Yes, Mike. As we look out over the next few years, I will say, we continue to think of bolt-on acquisitions as a core part of our growth strategy.

Sometimes people ask, did the UNIPOL acquisition squeeze out other opportunities, either financially or for management bandwidth reasons. And the answer is no. And then doubly so now with the integration essentially complete at this point.

But the thing that is going to drive our decision-making about acquisitions, our activity in that regard is going to be strategic fit and returns. We're not going to invest in an acquisition that won't produce the return requirements that we have. And those will be the two things that guide us going forward.

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

Mike, let me add on. We are very inquisitive. We keep looking at a lot of assets. As I have said in March I think the advantage coming out of Chapter 11 that is clearer now than it was when we were in Chapter 11, is our ability to partner or joint venture with someone. And those opportunities are also present. So we will keep working it. As Hudson said there's a financial -- we don't feel constrained financially.

Mike Sison - ***KeyBanc Capital Markets - Analyst***

Okay, great. And then in FCC, it was good to see volumes up in the first quarter. Can you maybe talk about the competitive environment? Has it stabilized a bit over the year and do you feel good about the industry moving in the right direction?

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

Yes, I do. It is clear that our customers are looking for what is that next product, catalyst product, that will allow them to get those next best yields. And I think across the industry as suppliers, we are all working very hard to provide that solution to the problems that our customers face.

I think from a customer's standpoint, as our customers, some of these refineries get a little bit more challenged in Europe and so on, that is putting some pressure on. But from an industry dynamic and the suppliers of catalysts, I think everyone is focused on providing the solutions that our customers need.

Mike Sison - ***KeyBanc Capital Markets - Analyst***

Great. And then could you update us on -- when you look to expand your capacity, some competitors have talked about debottlenecking. You've got the only big expansion some time in 2015. Do you still feel good about that? Is demand there to absorb that potentially longer term?

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

Yes, from a longer-term perspective, we strongly believe FCC capacity will be needed to supply the demand and the fundamental underlying demand of gasoline as well as propylene. It is still an effective method to get propylene. Whether it is the timing of it may be in question.

What we are doing is, we're starting this year the infrastructure in that Middle East unit. They have that infrastructure ready. And as we have said, we will time those plant operations with the regional demand.

Mike Sison - ***KeyBanc Capital Markets - Analyst***

Great, thank you.

Operator

Thank you very much for your question. We have no further questions at this time. I would like to turn the call back to Mark Sutherland for closing remarks.

Mark Sutherland - ***W. R. Grace & Co. - VP of IR***

Thank you, Chris, and thank you all for joining us this morning. If there are any questions that require further clarification or direct follow up, please feel free to call me directly at 410-531-4590. And again, thanks for your time and attention this morning. Good bye.

Operator

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Thank you very much. Ladies and gentlemen, that does now conclude your conference call for today and you may now disconnect your lines. Have a great day. Thank you very much for joining.

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