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GRA - Q1 2013 W. R. Grace & Co. Earnings Conference Call

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OVERVIEW:

GRA reported 1Q13 sales of $710m and adjusted EPS of $0.81. Expects 2013 sales to be just under $3.2b.

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Q1 2013 W.R. Grace & Co. earnings conference call. My name is Katherine and I will be your operator for today. At this time all participants are in listen-only mode. We will conduct a question and answer session toward the end of the conference. (Operator Instructions). As a reminder, this call is being recorded for replay purposes. I would like to turn the call over to Mr. Mark Sutherland, Vice-President of Investor Relations. Please proceed, sir.

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

Thank you, Katherine. Hello, everyone, and thank you for joining us today, April 24, 2013 for a discussion of Grace's first quarter 2013 results released this morning.

Joining me on today's call are 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. Links are available on the upper right corn of the page. 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 conditions. We will also discuss certain non-GAAP financial measures, which are described 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 the Q&A. We want to remind everyone that this webcast contains time sensitive information that is accurate only as of today. Any redistribution, retransmission, or reproduction of this call without company consent is prohibited. With that, I will turn the call over to Fred.

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

Good. Thanks, Mark. And good morning to everyone on the call. As noted in our preannouncement in this morning's release, our results fell short of our expectations for the quarter. Sales and earnings were impacted by customer operational issues, order delays and a weaker economic environment than we had planned.

What was more disappointing for us was the need to revise our 2013 outlook. In any given quarter, there are always events that are unfavorable, though they tend to be offset by favorable events. This is inherent to our business. This quarter, the events, however, did not balance out. By itself, this would not have caused us to revise our full-year outlook. We would have been able to take actions to replace the lost earnings. However, when these events were compounded with the weaker economic environment and the lower FCC catalyst in volumes we expect during our pricing transition, we believe it was appropriate to provide you with an updated view that takes all of these changes into account.

The global economic environment is clearly weaker than we expected, especially in Europe. We are seeing this in reduced demand across many of our businesses. We know that many of you are thinking about our 2014 goals. Even though the required growth from 2013 has increased, we remain focused on achieving these targets. We are making important progress in our growth programs and we remain as focused as always on expanding our margins through both pricing, productivity, and cost control.

In addition, we expect benefits from the new FCC catalyst pricing in 2014. More broadly, we have solid, market-leading franchises in each of our segments and our business fundamentals remain strong as demonstrated by our increasing margins and cash flow. When stronger global economic growth resumes, we will be ready to accelerate our growth and leverage the improvements we are making to our competitive positions. Let me highlight is several items from the quarter to demonstrate our efforts to build a stronger enterprise.

In late February, we announced an exclusive agreement with Chevron Lummus Global that allows our ART joint venture to sell hydroprocessing catalysts to their licensees and others from catalyst unit refills. This is an excellent win-win agreement as it allows both parties to do what they do best. CLG is the leading hydroprocessing technology licensor for fuels and lubricants and they have a superb win rate for the installation of new hydroprocessing technology.

For ART it expands the current product portfolio to cover a full range of hydroprocessing catalysts. It also provides additional reach into higher growth segments by building on ART's manufacturing and technical sales expertise. Responding customers will benefit as hydroprocessing catalyst supply and technical service are streamlined with ART as a single point of contact. We also recently closed a water proofing products acquisition in Australia. Although small the, revenues of about $10 million a year, this is the type of bolt-ons we like, providing complementary product technology, good cost synergies and immediate earnings accretion.

This acquisition gives us access to higher growth markets and broadens our technology portfolio. In March we announced changes to our FCC Catalyst pricing, which included eliminating the rare earth surcharge pricing mechanism and increasing the resulting new base prices by 10% or as contract terms allow. This increase is necessary to support Grace's continued investment in product technology, technical service and manufacturing capacity.

We are early in a multi-quarter of negotiations with our customers. In the short-term, we expect some volume weakness as customers exercise their negotiating prerogative to trial alternative catalysts, but we are confident that our sales volume will recover toward the end of this year as FCC Catalyst demand firms and we work through the trial period. Our customers face increasing complexity with a broad range of potential crude sources and increasing demands for environmentally friendly fuels and chemical feedstocks.

Improvements in catalyst technologies are often the solution to our customers' challenges, and we are focused on ensuring our technology provides the highest value possible. One final comment regarding our Chapter 11 emergence. Monday, June 17 has been set as the date for oral arguments before the Third Circuit Court in Philadelphia. We continue to be confident that we will receive favorable rulings from the Court, and we continue to target emergence by the end of this year. Thanks, and I will turn the call over for Hudson for more is specifics on the 2013 outlook.

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

Thank you, Fred. Please turn to pages 4 and 5 and we will start with the quick review of Grace's overall results for the quarter. Sales were $710 million, down 6% from last year. Pricing decreased 5% due to lower rare earth surcharges and currency translation was unfavorable 1%. Volumes were unchanged. Sales in western Europe declined 9%, excluding the impact of lower rare earth surcharges. Gross margin improved 50 basis points to 37.2% compared with last year due to lower manufacturing costs. Adjusted EBIT was $105 million, down 6% from last year as lower sales more than offset lower manufacturing costs and operating expenses.

Adjusted EBIT margin was unchanged year-over-year at 14.8%, and adjusted EBITDA margin increased 50 basis point to 19.2%. Adjusted free cash flow was $66 million for the quarter, more than double last Q1, driven by working capital reductions. Adjusted EBIT ROIC was just under 35%. Earnings growth and good working capital performance are offsetting recent investments in new capacity and bolt-on acquisitions. Adjusted EPS was $0.81 based on diluted shares of $77.2 million. Let's turn to catalyst technologies on page 6. First quarter sales for catalyst technologies were $267 million, down 15% from last year. Pricing decreased 14% driven by lower rare earth surcharges.

Sales volumes decreased 0.4%, reflecting the impact of lost sales due to customer operational issues, inventory reductions and order delays. Catalyst technologies gross margin was 40.3% for the quarter, a decrease of 170 basis points primarily due to lower sales, year-over-year differences in rare earth inventory accounting and lower operating leverage. Q1 2012 benefited from improved operating leverage as inventory was built in anticipation of plant maintenance shutdowns in the 2012 second quarter. Segment operating income was $77 million, down 22% from a year ago and down more than $15 million from our plan.

As described in our earnings release, about $7 million of the decline was due to operational issues at four large customers. These issues included two refinery fires, a delayed refinery startup and a one time polyolefin catalyst destocking. These earnings are not recoverable. We experienced an additional earning impact of about $5 million from delayed orders from five large customers. We expect to recover these earnings in future quarters.

Segment operating margin decreased 270 basis points to 29% as lower gross margin and lower ART earnings more than offset reduced operating expenses. Our share of ART's net income was $5 million, be down from last year due to the delayed sales. These results include the initial earnings from the CLG agreement. Looking forward, we expect strong sequential improvement in our catalyst results with Q2 sales and earnings growing double digits from Q1. For the full year, we expect catalyst segment operating income to be below 2012 on lower sales and higher margins.

Our FCC Catalyst business has experienced an unusually volatile three years. The dramatic increase and decrease in rare earth costs, the ongoing shift in refining capacity from Europe and North America to the Middle East and Asia and other changes have presented significant opportunities and obstacles for this business. During this time, we've stayed focused on helping our customers solve their most challenging problems. We've made significant advances in product technology and invested or committed millions in R&D, new manufacturing processes and capacity around the world.

At the same time, we have experienced significant growth in our polyolefin catalyst business, which provides a very attractive complement to our FCC and HPC Catalyst portfolio. Our long-term results in catalyst technologies reflect the strength of our three catalyst franchises. On current expectations, 2013 catalyst earnings will be up more than 50% from 2010 on more than 700 basis points of operating margin expansion. Let's move to materials technologies on page 7.

First quarter sales for materials technologies were $215 million, an increase of 0.5% from last year. Increased pricing of approximately 2% was offset by unfavorable currency translation. Sales volumes were unchanged. Sales in emerging regions increased 8% in the quarter to 41% of segment sales as we saw strong demand for engineered materials and packaging technologies in developing Asia, particularly China.

Sales in western Europe, which represented 32% of segment sales, declined 4% due to weaker end use demand, particularly for automotive and can-coating applications. Gross margin was 35.1%, up 330 basis points due to lower manufacturing costs and improved pricing. For operational reasons, we've built inventory in certain products in Q1 which will be sold in Q2. As a result, Q1 gross margins were a little higher and Q2 gross margins will be a little lower.

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The first half margins should average about 34%. Segment operating margin was 20.6% up 370 basis points due to higher gross margin and lower operating expenses. Please turn to page 8 for construction products. First quarter sales for construction products were $229 million, up slightly from the very strong year-ago quarter. Organic growth of approximately 2% was offset by unfavorable currency translation largely from the Brazilian real and Japanese yen.

This was the segment's tenth consecutive quarter of positive price and volume growth, which demonstrates the steady though slow improvement in secular construction trends. Emerging region sales grew 12% year-over-year, mostly due to good growth in Latin America, including the gains provided by our July 2012 acquisition in Brazil. Emerging regions now represent 37% of segment sales. Sales in North America declined 2% in total as a 4% sales increase in specialty construction chemicals was offset by a 7% decrease in specialty building materials.

The decline in specialty building materials sales is due in large part to weather. Q1 this year was typically cold and wet, while last year's Q1 was unusually warm and dry, allowing for more construction activity including residential reroofing in North America. Sales in western Europe were down more than 14% due to continued market weakness and our decisions to exit low margin businesses in the region. As noted in our February call, we expect 2013 to be another down sales year in western Europe and we continue to focus on right-sizing this business.

Although the GCP Europe business unit is profitable, its returns are below our targets. We are continuing to implement cost reduction initiatives in this business and have decided to exit a small loss making joint venture that the EMEA region. Segment gross margin improved 130 basis points to 35.5% due to ongoing success in recovering raw material cost increases, as well as benefits from volume leverage and productivity gains. Segment operating income was up 11% year-over-year and operating margin improved 100 basis points to 10% due to gross margin improvement and reduced operating expenses.

We continue to expect double digit earnings growth for construction products this year driven by sales growth in the emerging regions and North America. Leading indicators for commercial construction spending in the US have turned positive including commercial construction starts, the architectural billings index and residential construction activity. Based on current trends we should see improved sales volume growth in the second half of this year. One last comment on Q1 before moving to our outlook.

We focus continually on productivity and cost control across the Company. Improved manufacturing productivity contributed to our gross margin improvement this quarter. We also reduced SG&A costs by almost 6% year-over-year driven primarily by restructuring and other cost reductions in 2012. Let's now discuss our outlook. As you know, we lowered our outlook for 2013 adjusted EBIT to $540 million to $560 million an increase of 4% to 8% over 2012. This is a reduction of $20 million or about 3.5% from our original February outlook.

In broad terms, about $10 million of the revision is due to factors we experienced in the first quarter, including the lost catalyst sales and the Venezuelan devaluation, while the remaining $10 million is due to lower growth expectations in all three segments. We expect to partially offset these lower sales with further improvements in our manufacturing costs and operating expenses. To sum up our outlook, we now expect sales to be just under $3.2 billion with organic growth of 4% to 6%. We continue to expect gross margin to be in the range of 36% to 38% with a 100 basis point improvement in adjusted EBIT margin from 2012.

Adjusted free cash flow should be over $400 million again, in line with our three year target of over $1.2 billion. Please continue to use a book effective tax rate of 34% on adjusted earnings and a cash tax rate of 14%. Diluted shares outstanding at year end should be about 78 million shares. Given our weak Q1 earnings, we now expect a first half/second half earnings split of about 44/56 compared with a 46/54 split we expected in February. As Fred referenced in his remarks, we didn't like lowering our outlook, but we believe being transparent with you is more important, especially, in this time of economic uncertainty.

Our intent is to incorporate our best judgment about the opportunities and risks we have, and to provide an outlook that is as accurate and balanced as possible. Although Q1 was below our expectations and yours, our business fundamentals remain solid. We have great businesses with great growth opportunities, exceptional margins and high cash flow. We are managing for the long-term and creating new value for our customers and for you every day. With that, we will open the call for your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, (Operator Instructions). First question is from the line of Mike Ritzenthaler from Piper Jaffray. Please, go ahead.

Michael Ritzenthaler - *Piper Jaffray - Analyst*

Good morning, guys.

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

Good morning, Mike.

Michael Ritzenthaler - *Piper Jaffray - Analyst*

On the pricing within catalysts, navigating through the year-over-year weirdness of discontinuing the rare earth surcharge, while lifting the base pricing clearly the value -- the value in use sales proposition doesn't change, but are there any historical snippets to help us understand more granularly how this cycle differs from past cycles in terms of difficulty or length? Given that you had indicated in your prepared remarks, Fred, this strategy is expected to ultimately improve 2014. I'm trying to get a sense for the risk of slippage, which is the expectation and that seems reasonable versus more permanent losses and how that is being navigated or litigated?

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

Let me take a crack at that, Mike. First of all, in any given year about one third of our FCC business turns over. So meaning we can -- meaning we can negotiate the contract. So about a third of it is available for re-pricing in any given year. That is the generality of it. As you, as we and others initiate new pricing it allows our customers at that point to say, "Hey you know what? I have been being hounded by customer -- your competitor X, Y, Z. Let me take a shot at running a trial of their product." We have incorporated that in.

If you look at our 2013 on a volume basis, we think our FCC volume will be around only 1% up for the year 2013 reflecting about a third of those -- a third of that contracts available for are pricing. For FCC Catalyst in total we think it is about 3% for the volume for the total year. So, you know, we are going to -- we are going to push through this. We think it is the right thing to do. And we think it does set up the value creation going forward. But that is how we framed it out.

Michael Ritzenthaler - *Piper Jaffray - Analyst*

That does make sense, and thanks for helping us to clear up the strategy stuff. And can you update us on the state of the polyolefin catalyst destocking? Well, within polyethylene, I guess, more specifically was it is more or less contained to the large customer that you highlighted in your prepared comments? And I guess maybe a broader question has anything changed within the macro backdrop that affects the volume for 2013? I think, previously, we had discussed something along 78%. Is it less than that or is it, you know, is it a pricing --?

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

No, it is -- it is -- good question. Polyolefins, we think it is going to grow around 5%. Down from the 7% to 8% we thought in this year. And that really is based on some global economic criteria that is happening around Europe and the Middle East. That destocking is in one customer around both polyethylene just based on that demand. As they built a lot of inventory, I think they well, I know they've told us that the global demand has softened for the time being.

So, if you think of our forecast this year in our specialty catalyst, we think it is about a 5%. We've forecasted a 5% grower into this 2013. We think it will bounce back next year based on a couple of phenomena. One, hopefully, there is a better economic climate out there. Plus, the introduction of two new products that we have both in polypropylene and polyethylene should get us back to the high single digit growth that we have experienced.

Michael Ritzenthaler - *Piper Jaffray - Analyst*

Okay. And then with a positive bias on your concrete prices over the last couple months in North America and emerging regions, do you think that the lift in the specialty chemicals has started to manifest itself in the 1Q results, or do you think that is something that is still on the come?

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

I think it is on the come. I think a couple of things. One, the weather hasn't helped. We haven't really got a good view of it yet because there hasn't been a lot of pouring, especially in the northern pieces of -- northern regions. The other thing, quite candidly, is as you know our customers the big cement mills went out with a 10% price increase. Our intelligence says that has not been sticking.

Now, let's see what happens coming out of the first quarter as weather improves. Will they be able to capture that and then that pulls along a lot of the chemicals, as well. That is how we're thinking about it today in our 2013 look.

Michael Ritzenthaler - *Piper Jaffray - Analyst*

Okay. Thank you very much, guys.

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

Good.

Operator

Thank you. The next question is from the line of Laurence Alexander from Jefferies. Please, go ahead.

Rob Walker - *Jefferies & Company - Analyst*

Good morning. This is Rob Walker on for Lawrence.

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

Hi, Rob.

Rob Walker - *Jefferies & Company - Analyst*

Hi. I guess I understand it is early at this point, but what are your expectations, if any, in terms of an impact from catalyst demand from shale oil?

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

You know, we -- with all -- with what we are seeing, we candidly think that this is the impact on catalyst. We candidly think it is going to be neutral. Yes, there is, you know, shale oil is lighter oil, but we believe everything we have tested so far that there are some metals and they are iron is specific that will require -- that will eat up some more catalyst. So net-net of you're going to get some, you know, more bottoms or more heavier oil, net-net of some of the light shale oil, we think that that's -- well, we are forecasting is that impact is going to be neutral for the amount of catalyst it's using.

Rob Walker - *Jefferies & Company - Analyst*

Okay, thanks. And that I guess just given the recent signs of industry discipline around FCC Catalyst in terms of pricing, why haven't you increased your volume expectations from prior guidance?

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

We believe that as we transition, as I mentioned, as we transition to the new pricing it is -- it gives opportunities for our customers the opportunity to test new catalysts and through trials and others. So, you know, we've assumed, as I said, about a 1% volume increase for this year.

Rob Walker - *Jefferies & Company - Analyst*

All right. Thank you.

Operator

Thank you. The next question is from the line of Mike Sison from KeyBanc. Please, go ahead.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Hi, guys. I think that's me. But this in terms of your outlook, Hudson, for the earnings split first half/second half, I guess when I look at what you did in the first quarter it would imply that the second quarter would be he kind of 24% of the midpoint for the adjusted EBIT. Is that the way to look at it?

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

Honestly, Mike, I didn't do the math that way but I will trust your math.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

That is sort of the way we need to look at it, right?

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

Yes.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Okay, cool. And then for catalyst I thought you said that for this year it would be up 50% from 2010 levels?

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

I said more than 50%.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

More than 50%.

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

Yes.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Than 2010 levels. Okay. And that would imply that it looks like materials technology is going to have another very strong year and GCP, as you know it, will have another strong year. Is that the way to sort of model it out?

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

We think so. The construction business that we said was going to be up double digits it this year. We think materials technologies will have good are earnings growth on margin expansion, a little bit of sales growth, margin expansion and good cost control. When I said the 50% up on catalyst that wasn't intended to be guidance. We were intending to characterize the earnings power of this business over a period of time. So don't -- we didn't intend to be precise on that 50%.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Okay. And then the loss of sales from the large customers, the operational issues they have incurred and the delays at the five customers for ART, are those -- how long is that lingering in Q2?

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

It will be over a couple quarters. It is not all from Q1 to Q2.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Oh, wow. Okay.

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

Some of this will be later in the year.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Okay. And then just last one, you know, I saw you that you have a new sales agreement with in ART with Chevron Lummus. Can you just give us a feel for the potential there longer term?

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

Yes. I mean Mike, it's Fred. We are excited about it. You know, this year we believe ART will grow its earnings high double digits, maybe even close to 20%. And with the agreement that we have around the hydrocracking and the loop side of it, we believe that will continue, that rate of growth will continue over the next two years, 2014 and 2015 at that level. So we are very excited about it. What it does is, you know, as we look at it we believe that the majority of share that is being won in the hydrocracking new technology is Chevron Lummus and we want to -- and if we want to be able to have that share in the hydrocracking catalyst side. So we are bullish.

Mike Sison - *Key Banc Capital Markets, Inc. - Analyst*

Great. Thanks, guys.

Operator

Thank you. The next question is from the line of John McNulty from Credit Suisse. Please, go ahead.

John McNulty - *Credit Suisse - Analyst*

Yeah, good morning. Just a couple of quick questions. With regard to the $5 million that was delayed in earnings tied to some of your delayed customer startups, do you get that back, all of it back, in 2013 or does some of it drag out into 2014, as well?

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

I think 99% of it is going to be 2013, John.

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

Right.

John McNulty - *Credit Suisse - Analyst*

Okay, fair enough. And then when you think about the 2014 targets, which it sounds like as of now you are still pretty convinced you can get to it, we are looking at what looks to be about a 20% EBITDA increase from 2013 to 2014 kind of based on the middle of your range for this year. So I guess if you can maybe give us an update as to how you actually get there and how much of it is kind of self-help or self-driven, and how much of it is macro driven, just so we can get a better feel as to how realistically you are going to be able to get to those targets.

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

John, this is Fred. Let me take a shot at how you we think about it, and we obviously think about it in detail. If you think of just volume growth. Volume growth in 2013 for us across all of our businesses will be around 3% to 3.5% when it all shakes out. We believe volume growth for 2014 has to return back to its more historical levels of 4% to 5%. So pure volume growth across our business is back to 4% to it 5%, and the incremental volume on the installed base we have has a nice contribution margin with it. That is a big chunk of it.

You think of productivity, we have been successful expanding our overall margin about 100 basis point or one point. You are going to see in the second quarter restructuring actions that we have taken, mainly in Europe, that gives us the confidence that we can be repetitive and that productivity or expanding those margins another point above what we have done in 2013. The third piece of it is around some key growth programs initiatives we have that will accelerate over 2013. It is around a couple of the polyolefin new catalysts that I've talked about that will reaccelerate that growth from this year of 5% back up to high single digits again, as well as the ART earnings on that trajectory rate. The last piece of it, which is a significant piece, as well, is the success on the FCC Catalyst.

We need to be successful on moving this industry higher on the FCC Catalyst pricing. If you do the math on that and we are -- and we are moderately successful and you add all these pieces together that is why we haven't come off the 2014 target.

John McNulty - *Credit Suisse - Analyst*

Great. Thanks for the color. Maybe one follow-up on that. On the pleasing change that you have had in the catalyst side, have you seen any change relative to kind of historical moves as to how your competition is reacting to that?

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

I can tell you we have got some price already based on the announcement that I think it was mid-March that we put out. I don't think -- I don't think the dynamics have changed, you know. Competitors have new catalysts. They are eager to get in front of a customer to trial. But that happens all the time. The short answer is no; I haven't seen anything. We have got some pricing already, and we will work through it through the year.

John McNulty - *Credit Suisse - Analyst*

Great. Thanks very much. Thanks for taking the questions.

Operator

Thank you, John. The next question he is from the line of John Roberts from UBS. Please, go ahead.

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

Do we have John?

Operator

Hello, John. Your line is live into the call. You are free to ask a question. Thank you.

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

Operator, let's move on, please.

Operator

Thank you. The next question is from Jim Barrett from C.L. King and As.

Jim Barrett - *CL King & Associates, Inc. - Analyst*

Good morning, everyone.

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

Good morning, Jim.

Jim Barrett - *CL King & Associates, Inc. - Analyst*

Fred, when you looked out to 2014 and beyond, the proposal by the EPA to reduce sulphur content of gasoline from 30 to 10 parts per million by 2017, is that a relatively minor eventuality if it comes to pass or what is your level of optimism and significance you place on that event?

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

We think it is significant and especially if it culminates across the globe in a step-down in China as well as Asia, as well as Latin America. And if you look in China why we get excited about it is the Chinese have decided or predominantly decided they are going to get at it through you putting hydrocracking in as the first phase. If that does come to fruition this will be a good thing for both our industry and W.R. Grace.

Jim Barrett - *CL King & Associates, Inc. - Analyst*

Okay. Not to belabor the point about FCC pricing, but the fact that you expect as -- that certain customers will trial other competitors. Does that suggest that not all of your competitors have also announced similar price increases because you certainly one has been very visible about it?

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

You know, I think it is too early. I mean we -- listen, everybody -- it is easy to do announcements. Where the real proof is what happens as we play this out and it really is early. But I think, you know, given what the industry is facing, the refining industry is facing, with new regulations around sulfur, different slates of crude based on the light and the shale coming in, other bottoms cracking issues, the industry needs to count on the catalyst suppliers to continue to invent new solutions to their issues. It is the cheapest way to get at it. And I think they will. So, you know, that is where we are at.

Jim Barrett - *CL King & Associates, Inc. - Analyst*

Okay. Well, that is helpful. Thank you very much.

Operator

Thank you. The next question is from the line of Patrick Duff from Glider. Please go ahead.

Patrick Duff - *Glider - Analyst*

Hi, good morning, guys. Thanks for taking the questions.

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

Hello, Pat.

Patrick Duff - *Glider - Analyst*

First, Fred -- or excuse me, Hudson, I just wanted to check. I didn't do a DSO but the inventories, ending inventories looked a little high relative to your kind of rate of growth last year and particularly relative to, you know, kind of the volumes in the business. Would you think of -- I know it was overall pretty good working capital turns here in the first quarter. Do you see inventories being a source of cash for you over the course of this year from where we are now?

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

The answer is, yes. The -- you know, we are still working through kind of the last bits of high value rare earth inventory. That is being replaced at lower cost so that helps us. Materials technologies did build some inventory in Q1 for operational issues. That will be sold in Q2. And construction did its normal inventory build as they prepare for the stronger Q2 construction season.

Patrick Duff - *Glider - Analyst*

Okay. All right. Great. And then just, you know, as we look at the revised guidance and then kind of looking out on, you know, how this is going to set us up for next year and whether or not we have kind of totally captured the overall economic environment, I guess just a couple of recent data points. It seems from a macro basis March was probably the weakest month of the first quarter for a lot of companies. I don't know how you would feel about that statement.

But then, you know, some of the data points that are coming out lately, we did see a tick down in the ABI index, like 54 to 51. We are seeing, you know, really kind of low operating rates in the -- at least, the US North American refining, and I think the gas inventories are it 2.5%, 2.8% higher year-over-year.

I know it is always difficult and you are doing your best job to give us your sense of how the rest of the year is going to be playing out, but as you kind of sit and look at the belated data points that are coming in for the businesses that you are selling into, how would you describe your overall level of confidence that you are capturing the -- you know, the magnitude of the change in economic environment that you are all calling out?

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

Pat, it is -- we would not have lowered our guidance if it wasn't but for the general economic weakness, especially in Europe. We are seeing a little bit in China, and then places around some of Latin America. We factored that in. Now, we hope we factored in enough of that and maybe -- and maybe on the positive side that we will see some surprises on that piece of it. But you know, we wanted -- we wanted to ensure as we looked at it that we weren't fooling ourselves given -- given what we had saw in 2012. So when we looked out we said how bad could 2013 be on a volume basis on Europe and so on.

And I think we factored in some of that. I mean our overall volumes will be, as I said, volume, just volume growth will be about 3%, and I mean you know we have got a franchise in the construction side that is going to grow. Grow well. So I think it is balanced. You know, our contingency planning is around the cost side. And we have -- and we have accelerated some of those actions around Europe and some of the restructuring and some operations were shutting down, as well as some sites were consolidating that. We are not waiting, so we will get off and try to get ahead of that.

Patrick Duff - *Glider - Analyst*

Okay.

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

Fred, you balanced it nicely. We don't want to miss the growth opportunities; we are focused on that, we've got to prepare for a weaker environment and that's the productivity side of the equation.

Patrick Duff - *Glider - Analyst*

All right. I appreciate it. And I'm sorry, if I may just kind of lob one more in. Fred, when you talked about the drivers to 2014, and around the areas that you highlighted, the bolt-on acquisition is -- was not in that menu of opportunities. You know, we know there is a potential, sizeable acquisition that might happen here much bigger than a bolt-on. Maybe more generally any kind of thoughts or updates on the likelihood of at least some bolt-ons maybe coming into the fore. I know you mentioned Australia, but anything else that you are feeling any more optimistic on?

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

Yeah, the pipeline on the small ones, they are there. They do feel -- they feel good. We are -- as we highlighted Australia because when we do the bolt-on I wanted to give you a context that we generally think they are accretive, and they he generally are accretive. So those will come in. They will come in, you know, based on the normal timing. We are working it. We are not -- let me get -- let me step back. We are not constrained to do those. We are not constrained by our cash position or constrained by what we think the market environment is. On the large one that could come available, we think we are well positioned. We think we are well positioned for that, and, you know, based on some of the things we done.

Patrick Duff - *Glider - Analyst*

Great. All right, well, I appreciate the effort. Thanks very much.

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

Thanks, Pat.

Operator

Thank you. The next question is from the line of Chris Shaw. Please go ahead.

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

Good morning, guys. How are you doing?

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

Good, Chris.

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

Just a follow-up I think on a couple of other questions that people were trying to get at. You know , if the FCC, some of your competitors have also indicated some price hikes, is there any opportunity for you to achieve some trial volumes away from them when they enact their price increases?

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

Yeah, sure. It is a natural -- it is a natural phenomena that happens both ways, yes.

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

But that wouldn't be enough to offset what you are -- some of the other stuff you were losing for the year, I guess?

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

We've factored in, as I said, you know, about a 1% volume growth and so on. We want to make sure that given what the refining industry is going to go through you the next, you know, 24 to 36 months that the value of catalyst, which we really truly represent, is priced in. And it would be a shame in the industry -- if the industry didn't take advantage of that situation.

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

Can you tell me in construction materials, typically, if you have lost some, I mean not even lost but if sales were a bit weaker due to the weather is that something that gets made up over the course of the year or pushed into the next quarter or is it just something that just doesn't happen and you don't really ever make it up. Do you know? Do you have experience with that?

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

It generally tends to get pushed. What happens is you got a bad winter. For us it is on the residential reroofing side of it. If they can't start reroofing until later into the season some of that may get pushed into the next season. You just can't get it all in, right.

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

All right.

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

That is the issue on it.

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

Okay. Great. Thank you.

Operator

Thank you, sir. You have no further questions at the moment. (Operator Instructions).

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

Katherine, I think we are all set for this morning's call. We had a good Q&A session here. Why don't we wrap up the call. I would just like to leave my direct dial phone number for any further questions or clarification from analysts. My dial direct dial number is 410-531-4590. And with that we will end the call. Thank you all for attending.

Operator

Thank you for joining in today's conference. This concludes the presentation. You may now disconnect, and have a very good day.