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# EDITED TRANSCRIPT

GRA - Q4 2019 W. R. Grace &amp; Co Earnings Call

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**OVERVIEW:**

Co. reported 4Q19 sales of \$505m and adjusted EPS of \$1.31. Expects 2020 YoverY sales growth to be 0-3% and adjusted EPS to be \$4.73-4.91. Expects 1Q20 adjusted EPS to be \$0.65-0.72.



FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

## CORPORATE PARTICIPANTS

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

**Jeremy F. Rohen** *W. R. Grace & Co. - VP of Corporate Development & IR*

**William C. Dockman** *W. R. Grace & Co. - Senior VP & CFO*

## CONFERENCE CALL PARTICIPANTS

**Adam Samuel Bubes** *Jefferies LLC, Research Division - Equity Associate*

**Anthony Walker** *Goldman Sachs Group Inc., Research Division - Research Analyst*

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

**John Patrick McNulty** *BMO Capital Markets Equity Research - Analyst*

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

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

**Michael Joseph Sison** *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Fourth Quarter 2019 W.R. Grace and Company Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Jeremy Rohen, Vice President, Investor Relations. Please go ahead, sir.

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**Jeremy F. Rohen** - *W. R. Grace & Co. - VP of Corporate Development & IR*

Thank you, Sydney. Hello, everyone, and thank you for joining us today for Grace's fourth quarter and full year 2019 earnings call. With me this morning are Hudson La Force, Grace's President and Chief Executive Officer; and Bill Dockman, Senior Vice President and Chief Financial Officer.

Our earnings release and presentation are posted on our website under the Investors section at [grace.com](http://grace.com). Please note that some of our comments today will contain forward-looking statements based on our current view of our business, and actual future results may differ materially. Please see our recent SEC filings which identify the principal risks and uncertainties that could affect future performance. We'll discuss certain non-GAAP financial measures, which are described in more detail in this morning's earnings materials. Reconciliations of non-GAAP financial measures and other associated disclosures are contained in the earnings materials and posted on our website.

This morning, Hudson will touch on our 2019 performance, our 2020 outlook and progress around our key strategic initiatives. Bill will then review our business results and provide additional color on our outlook.

So with that, please turn to Slide 4 in our earnings presentation, and I'll turn the call over to Hudson.

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## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

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

Thank you, Jeremy. Good morning, everyone.

This morning, we have 3 key messages. One, our team delivered solid results in a very challenging 2019. Two, we expect slow sales growth in 2020 given the weak global manufacturing environment and the significant uncertainty from the coronavirus, but we expect stronger earnings and cash flow growth. And three, we made tremendous progress on our strategic growth initiatives in 2019, strengthening our foundation for long-term growth.

Now let me add some details to each of these points. As you'll recall, we experienced 4 discrete events in the middle of 2019, which affected earnings by approximately \$36 million. Three of these events affected customers and were outside of our control. The fourth was a manufacturing disruption from an equipment failure in our Materials Technologies business. Following these events, we acted decisively to adjust our manufacturing operations, reduce costs and identify new sales opportunities. Our aggressive response allowed us to offset more than half of the negative effect of the 4 events in less than 2 quarters.

Sales, earnings and cash flow all grew in 2019. We improved pricing, expanded adjusted gross margins by 70 basis points and delivered adjusted free cash flow of \$247 million. Q4 earnings and EPS were at the high end of our revised outlook range, and cash flow is at the high end of our original February 2019 outlook. These are strong indications of our team's ability to execute in a challenging environment.

Please turn to Slide 5. As you well know, the global manufacturing environment weakened significantly in the second half of 2019. Industrial production weakened as did plastics demand and refined products demand. According to industry consultants, U.S. domestic polyolefin plastic demand decreased 5% in 2019 and U.S. refinery production decreased 2%.

In January, the coronavirus emerged as a significant new uncertainty. We are concerned for the individuals affected by the virus and have taken steps to protect the safety of our employees in China and other countries. At this point, there is limited information about how much the virus may spread and how it may affect global economic conditions. Many China customers are still closed due to the extended Lunar New Year holiday. Clearly, there will be an impact in China and other countries as companies adjust to the effects of the virus. Our outlook adjustment assumes direct and secondary effects from customers in China and outside of China but does not assume that the virus triggers a broader recession. China sales are 5% to 6% of our total global sales. We expect information on the virus to change daily in the coming weeks and are monitoring developments closely.

We are establishing our 2020 outlook in a period of increased uncertainty. Last week, we fully expected to affirm the preliminary sales and earnings outlook we gave you in October. But given the uncertainties related to the coronavirus, we are reducing our outlook slightly and widening our outlook range. For the full year, we expect sales to grow 0 to 3%, adjusted EBIT to grow 6% to 10% and adjusted EPS to grow 8% to 12%. Earnings are growing faster than sales based on expected margin improvements in 2020 and the onetime nature of the 2019 discrete events.

Q1 will be the weakest quarter of the year based on 4 roughly equal factors. First, we expect lower customer demand based on the weak manufacturing environment at the end of last year. This will be most evident in chemical catalysts for industrial applications and silicas for coatings and industrial applications with lower customer demand and some inventory destocking. Second, in our Refining Technologies business, we expect weaker demand due to significantly higher-than-normal refinery turnarounds in Q1. While we expect total refinery turnarounds for the full year to be about flat with 2019, they are up more than 60% for our customers in Q1. FCC sales will also reflect sales loss after the customer refinery fire last June. ART will be back half weighted following a very big Q4 before the effective date of the new IMO regulations. Third, we have adjusted our outlook for the potential effects from the coronavirus, including sales to China customers and customers outside of China. Obviously, we expect this to hit Q1 hardest. And fourth, in Q4, we reduced manufacturing rates in response to lower demand to ensure our inventory levels remained in line. Underabsorbed costs from this action will reduce Q1 earnings. This disciplined approach reduces earnings in the short term but improves cash flow. Together, we expect these temporary factors to reduce Q1 sales by low double digits versus Q1 '19 with adjusted EPS at \$0.65 to \$0.72 per share. I expect these macro effects to be short-lived, and I'm confident in our full year outlook and the benefits we expect from our new growth capacity, new products, commercial excellence and operating excellence initiatives.



## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

Please turn to Slide 6. We made tremendous progress on our strategic growth initiatives in 2019, strengthening our foundation for long-term profitable growth. We have strong strategic positions in our catalysts, licensing and specialty silica gels businesses, and we don't take that for granted. We are making a number of investments to accelerate our growth and extend our competitive advantages. Over the last 3 years, we have invested over \$250 million in new growth capacity and more than \$26 million in our commercial excellence and operating excellence initiatives. These investments are starting to pay back, and we expect the payback to accelerate in 2020 as the new growth capacity comes online midyear and the commercial excellence and operating excellence investments mature.

As we've communicated, the Grace Manufacturing System investments alone added 75 basis points to 2019 gross margins. We have many other opportunities to improve profitability. Most recently, we initiated an FCC manufacturing network optimization program that will reduce our manufacturing costs by \$6 million annually when fully implemented in Q2. We remain focused on managing costs and inventory levels and driving productivity through the Grace manufacturing system.

When I step back and consider the progress we've made plus the strong customer demand for our high-value technologies, the sustainability benefits we deliver to our customers and the fundamental growth drivers in the end markets we supply, I am confident in our ability to deliver mid-single-digit sales growth in the long term and our ability to deliver our earnings and cash flow targets.

Please turn to Slide 7. Sustainability has become much more important to our customers, our investors and to us. For decades, we have helped our customers achieve their product performance and manufacturing process goals. During this time, helping customers solve their problems became a core part of our value model. Today, customers are asking us to help them achieve their sustainability objectives as well, and a significant portion of our sales come from products specifically intended to do so. Our products and technical services help our customers improve the efficiency of their processes and products, reduce energy, water and raw material use, cut harmful emissions and reduce waste. They help our customers make products that meet the toughest environmental standards and address rising consumer and regulatory expectations for sustainability, human health and safety.

Last year, we introduced this chart to you, highlighting our products that directly contribute to our customers' sustainability objectives. In 2018, these products totaled \$1 billion or 38% of sales, including our ART joint venture. In 2019, that total increased to \$1.1 billion or 44% of sales, and we expect the total to continue to grow. Over 65% of our current R&D activity is focused on new products for our sustainability portfolio, and our top 3 growth capital investments are for these products as well.

We also focus on sustainability through operating excellence, continually tracking progress toward our goals of no one hurt, nothing out of place and no harm from our products. The discipline of continually improving the efficiency and performance of our manufacturing and integrated supply chain is deeply embedded in our culture and annual operating plans.

I'll now turn the call over to Bill, who will discuss our business performance and full year 2020 outlook in more detail.

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**William C. Dockman** - *W. R. Grace & Co. - Senior VP & CFO*

Thanks, Hudson, and good morning.

Let's turn to Slide 9. In the fourth quarter, Catalysts Technologies sales decreased \$15 million primarily due to lower sales volumes, including the \$22 million impact related to the discrete items. The decline was partially offset by about 150 basis points of improved pricing. In Refining Technologies, sales were down 6% on lower sales volumes primarily due to the customer refinery shutdown in June 2019, partially offset by improved pricing. For the trailing 12 months, FCC pricing was up well over 200 basis points. Our commercial team is actively working to replace lost sales volume while maintaining our disciplined value-selling strategy.

In Specialty Catalysts, sales were down 1.6% due to 2 discrete events: the customer-specific inventory correction and the attack in the Middle East as well as slower global manufacturing environment. For the year, we announced 6 new UNIPOL polypropylene process technology licensing totaling approximately 2,500 kilotons of annual resin capacity, which will continue to drive long-term catalyst and donor sales.

## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

Segment operating income was up \$20 million, including \$1.6 million in higher income from our ART joint venture and \$8 million of business interruption insurance proceeds. Operating margin for the quarter was 34.7%. Excluding the \$8 million of business interruption insurance, operating margin would have been 32.6%. Our policy has a \$25 million limit, and we expect to receive additional insurance recoveries related to this event in 2020.

Moving to Slide 10. Materials Technologies fourth quarter sales were up 2% on a constant currency basis driven by improved pricing. Consumer/pharma sales were up 10% in the quarter. However, weaknesses in coatings end markets continue.

Operating income for the quarter was down \$1.7 million. The decline and drop in operating margin were primarily due to a \$4 million impact of actions to control inventory levels in response to the slower global manufacturing environment.

Now let's turn to Slide 11 for a review of our consolidated results for the fourth quarter. Q4 sales were down \$505 million, down 2% on constant currency. The sales decline was primarily due to a 4% impact from the discrete items. Adjusted EBIT was up 13% on improved pricing as well as lower manufacturing and operating costs. Adjusted EBIT margin was 26.6%, including a 1.6% benefit from insurance recoveries. Adjusted EPS was \$1.31 per share, up 15%.

Please turn to Slide 12 for a review of our full year 2019 results. For the year, sales were up 3% on a constant currency basis driven by improved pricing of 240 basis points across all businesses and the Q1 benefit from the 2018 Specialty Catalysts acquisition. Sales volumes in the second half were down 5% after solid mid-single-digit growth, in line with our original outlook in Q1 and Q2. The impact of the discrete events of the second half sales volumes was 3.5%.

For 2019, we also grew our adjusted earnings and adjusted free cash flow. Adjusted EBIT was up 3.6% on improved price and favorable mix. Our team's strong execution of mitigation plans delivered \$20 million of cost savings and insurance recoveries to partially offset the \$36 million of reduced earnings created by the 4 discrete events. Importantly, these decisive actions resulted in strong adjusted free cash flow of \$247 million.

Turning to Slide 13. In 2019, we made significant progress on our strategic growth investments. Three major strategic growth capacity investments come online in 2020. These investments will begin to contribute to sales and earnings in the second half of 2020, but more importantly, will support our long-term growth. In 2019, we invested \$194 million of capital with nearly half the investment dollars directed towards high-return strategic investments. For the year, we returned over \$100 million of cash to our shareholders, including \$73 million of dividends and \$30 million in share buybacks.

Finally, we achieved our goal of reducing our net leverage ratio below 3x by year-end 2019. In the second quarter, we told investors that we would prioritize deleveraging over additional share buybacks. The purpose was to focus on lowering our net leverage to our target range of 2 to 3x by the end of the year.

Finally, let's turn to Slide 14 and take a look at the key assumptions underlying our 2020 outlook. With -- while the slower global manufacturing environment in 2020 and uncertainty around the coronavirus tempers our outlook for the full year, we are confident in our plan and ability to execute. Our businesses are well positioned to capture growth in our end markets and to expand margins, grow earnings and drive strong cash performance.

For the full year, our plan reflects a modest revenue growth of 0 to 3% with improved pricing and higher sales volumes across our businesses. We expect 2020 adjusted EBIT in the range of \$500 million to \$520 million, up 6% to 10%; and adjusted EPS in the range of \$4.73 to \$4.91 per share, up 8% to 12%. Earnings growth and margin expansion will be driven by higher gross profit, lower manufacturing costs and continued benefits of our GMS and commercial excellence investments.

For 2020, our quarterly earnings profile is more heavily weighted to the second half. We expect Q1 adjusted EPS to be between \$0.65 and \$0.72 per share, down significantly year-over-year. Headwinds in the first quarter include the Q4 effects of inventory control actions, significantly higher-than-normal refinery turnarounds in Q1 and weak demand for chemical catalysts and silicon products in China given the uncertainty around the coronavirus.



## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

Looking at the second half of the year, the tailwinds from the major capacity additions, the decrease in refinery turnarounds and continued benefits of GMS give me confidence in delivering our plan. Our 2020 adjusted free cash flow is expected to be between \$260 million and \$280 million, up from \$247 million in 2019. The strong cash generation reflects higher adjusted EBIT and a partial year of dividends from ART. Capital expense is estimated to be approximately \$195 million. For 2020, we expect the cash paid for legacy matters will be approximately \$20 million.

Finally, in 2020, we expect to continue to prioritize reducing our net leverage in the range of 2 to 3x while continuing our share repurchase program at a conservative level. That said, we continue to evaluate accretive bolt-on acquisitions and will balance these opportunities with maintaining our low net leverage ratio.

With that, I'll turn the call back to Hudson for some final thoughts.

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

Thank you, Bill.

Our team delivered solid results in a very challenging 2019. The new year brings new challenges in the macro environment, and I expect us to deliver solid results this year, too. We've made tremendous progress with our growth investments and Grace Value Model initiatives, and my excitement for our long-term sales and earnings growth opportunities has increased. We are confident in our strategic direction and the long-term earnings power of our businesses. We look forward to your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And our first question comes from Christopher Parkinson with Crédit Suisse.

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

So you're fighting coronavirus as a formidable headwind in '20, which is disproportionately hitting 1Q. Just given your actual exposure in China, can you just walk us through the other buckets you mentioned on your thought process in the total global effect, so to speak, so I guess demand procurement, customer hesitancy regarding inventories? Just any color on those would be appreciated.

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

Okay. Thank you, Chris. This is Hudson. So as we thought about this, we're expecting effects from customers that are based in China who are seeing either lower demand or simply aren't able to operate because of the restrictions on travel or logistics or the availability of their workforce. But we don't think that will be -- that effect will be limited to China-based customers. We have customers in other countries who are -- who will -- who manufacture their products for export to China, and we think those local China effects will back up and start to affect customers outside of China as well.

From a supply chain perspective, from a Grace supply chain perspective, the effects are pretty limited. We have -- the major material that we source from China is rare earth. As we've talked on other calls, we have significant inventories and contingency plans around rare earth that we've put in place for other reasons, but they're just as effective and just as operable in this situation. We don't have any Grace owned manufacturing operations in China, and we have about 50 employees in China. And so that hopefully covers the landscape in terms of the effects that we expect to see, Chris.



## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

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

And just as a corollary of the first question, your 1Q guide does appear a little weaker than some of us were anticipating. Can you just walk us through the key buckets driving this caution in 1Q outside of coronavirus? But then potentially, more importantly, can you just highlight on some of the things kind of towards the end of 2Q in the second half? You mentioned ART contributions, but what are some of the other things we should all be considering in the investment community?

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

Sure, I -- Chris, I appreciate the question. So when I think about the negatives affecting Q1, it really breaks down to 4 things. They're roughly equal in size in terms of their effect on earnings. The coronavirus is one. We expect the effects of the coronavirus to be most significant in Q1. We would expect some Q2 effects. And I guess I should add a little color to this. We expect the coronavirus effects to be pretty significant in the short term, but not that long in duration. I -- we would expect them to start to wane by Q2. And I'll say, I want to acknowledge, this is based on the information that we have at this time, but it is our expectation. One. Two, we did see weak demand in Q3 and Q4. It was most notable in the -- our chemical catalyst business that's part of our Specialty Catalysts business and in our coatings and industrial end-use applications in Materials Technologies. We expect that to continue into Q1. There is some reduced demand. There's clearly some destocking that is occurring, not so much of our products but of our customers' products. They're working to control their inventories.

The third effect is this significant increase in the amount of refinery turnarounds in Q1. It's sort of unprecedented to have as many refineries and turnaround status in the -- at the same time in Q1.

And the last piece, Chris, is the unabsorbed costs from our Q4 manufacturing actions rolling into Q1. If you think about those, they're all temporary, either Q1, maybe a little bit of Q2 effects that will pass. And when we get into the second half of the year, the tailwinds start to kick in. As Bill hit on some of these in his remarks, we've got the new plant starting up, we expect ART to be stronger in the second half than the first half and we expect some productivity improvements that will run through the P&L in the second half. And part of why the second half is as strong as it is from a growth rate perspective is because we're comparing to a weak second half last year. That's when all the discrete events happened. And that's adding about 10 percentage points to year-over-year growth in the second half just because of that compare against the discrete events last year.

**Operator**

Our next question comes from Kevin McCarthy with Vertical Research Partners.

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

In Slide 6 of your deck, you referenced 3 capacity expansions in 2020 in polyolefin catalysts, hydroprocessing catalysts and colloidal silica. Do you expect those expansions to be a net positive or a net negative in 2020? In other words, just wondering if they can be loaded sufficiently to overcome whatever incremental depreciation burden you might have from those units. Maybe you can kind of talk through how you're thinking about that relative to your 2020 guidance.

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

It's a great question, Kevin. Thank you. We do expect them to be net positives in the second half. And you're exactly right that the depreciation will kick in, but we do expect good initial volumes in all 3 of these plants. And as a strategy, one of the things that we've done is focus in on these Grace, what we call GMS, the Grace Manufacturing System, initiatives, to make sure we're generating productivity dollars and cost savings across the whole portfolio to reinforce the profitability of these investments as we go forward.





FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

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

Okay. That's helpful. And then as a second question, I wanted to ask about the magnitude and possible timing of insurance recoveries that you anticipate in 2020.

**William C. Dockman** - *W. R. Grace & Co. - Senior VP & CFO*

Yes. This is Bill. Yes. We're continuing to work with our insurer, and we would expect to be able to recover the balance of the policy in 2020, probably more heavily weighted to the first half.

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

So, Bill, is that \$17 million?

**William C. Dockman** - *W. R. Grace & Co. - Senior VP & CFO*

That's right. That's the -- that's what's still available under the policy, and we expect we'll be able to collect what the balance is.

**Operator**

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

**Anthony Walker** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Anthony Walker on for Bob. On the full year guidance, how much of the earnings bridge would you say is in your control for 2020? You quantified the year-over-year impact from onetime add-ins at about half of the expected increase. What percentage of your increase is driven by cost-out initiatives or other self-help opportunities?

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

Anthony, it's Hudson. There's a significant part of self-help in our 2020 plan, and it includes the plant expansions coming online that Kevin asked about a moment ago. It does include productivity initiatives. We're seeing some lower inflation in the second half of the year. And so there's a lot that we consider in our control.

**Anthony Walker** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. Great. And then following up on the last question as well, can you provide an update on the progress replacing the lost business associated with the customer bankruptcy from last year?

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

Of course. We -- so this event happened in June of last year, June of 2019. We immediately began implementing approaches with customers to try to replace that lost volume. But the sales cycle on this type of volume can be long, and we want to do this in a way that does not change our value-selling strategy or is in any way disruptive from an industry perspective. And so we have approached customers. We've started product introductions with them, testing new products, the kind of high-value products that we want to have in our portfolio for the long term. We're well down the path on that, but we wouldn't expect that volume to be commercial until late this year.





FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

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**Operator**

And our next question comes from John McNulty with BMO Capital Markets.

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**John Patrick McNulty** - *BMO Capital Markets Equity Research - Analyst*

With regard to the impacts that are nicking 1Q, it seems like if you're -- if I'm understanding it right, you basically took 1 percentage point of EBIT out of your full year guide tied to the coronavirus. So call it, I guess, that would equate to about \$5 million or so. Is that the way we should be think -- when you say kind of all 4 of these buckets are roughly equal, is that the right way to be thinking about what the earnings impact is aside from the sales impact that you've already given clarity around?

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

Thank you, John. It's a good way to frame it, and I think you're right. The -- if you think about the delta from Q1 '19 to Q1 '20, that's what we were trying to bridge for you all. And the way you came at it, I think, is an insightful way as well. We took \$5 million off the top end -- relative to what we had said in October, we took \$5 million off the top end of our EBIT guidance and \$10 million off the bottom end of our EBIT guidance as the adjustment for the coronavirus. And to your point, we put almost all of that into Q1. It may prove to be conservative. I hope it proves to be conservative. But at this point, it's appropriate given what we know about the virus and the business -- the commercial effects.

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**John Patrick McNulty** - *BMO Capital Markets Equity Research - Analyst*

Got it. And then with regard to your cash flow, so it -- you put up some solid numbers in 2019. You're going to see some decent growth in 2020 as well, and that's even with kind of still a little bit of an above-average CapEx spend. I guess how -- now that your leverage ratios are down below 3, I guess how are you thinking about capital deployment? It sounds like debt reduction still is kind of a priority, but I guess how are you weighing that vers buybacks, vers M&A opportunities, et cetera?

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**William C. Dockman** - *W. R. Grace & Co. - Senior VP & CFO*

Yes. This is Bill. Yes. We're continuing the same strategy we talked about in the middle of last year. We're going to put the emphasis on deleveraging over share buybacks, if I'm just looking at those 2 by themselves. But as I mentioned too, we're continuing to look at acquisition opportunities. And so if the right opportunity comes along, we'll certainly take a close look and potentially use some of our cash for that or if it's significant enough, we'd consider taking additional debt if it's the right deal.

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**Operator**

Our next question comes from John Roberts with UBS.

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

The weaker auto industry is affecting the polypropylene industry. Does that have any impact down the road for your polypropylene catalyst and licensing businesses or maybe a lagged or delayed weakness that you might see?



## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace &amp; Co Earnings Call

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

John, it's Hudson. We've seen -- from an investment perspective in terms of customers continuing to make investments in future polypropylene capacity, we've seen that as a strong growth driver. We've seen it in the 6 licenses that we announced last year. We have expectations for additional licenses in 2020. And so we see our customers' investments at a pretty steady rate in terms of them bringing new capacity on. Auto is obviously a portion of total polypropylene end-use demand. I think it's order of magnitude 15%, something like that. So it certainly weighs on how our customers think about it. But we haven't seen that manifest in terms of delayed projects or diminished cadence of projects.

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

Okay. And is there anything you can tell us about the Lummus Technology processes underway? Can you say that's something Grace is not involved with? Or do you think it might change the competitive dynamics in any of your markets depending on who it's sold to?

**Jeremy F. Rohen** - *W. R. Grace & Co. - VP of Corporate Development & IR*

Yes. This is Jeremy. I wouldn't comment on the -- an active process that's out there. But in terms of the competitive dynamics, I don't see a transaction, especially the one that they announced, impacting the balance or the ART joint venture relationship.

**Operator**

And our next question comes from Mike Sison with Wells Fargo.

**Michael Joseph Sison** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

When we take a look at Q1, it looks like adjusted EBIT will be down double digits in line with kind of the EPS outlook, so I guess it implies 2Q, 3Q, 4Q pretty strong double digits. Can you maybe walk us through some of the timing of your FCC customers coming out of maintenance turnarounds? And do you see that double-digit recovery in 2Q? Or is it still a little bit kind of lagging into 3Q and in the second half of the year?

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

Mike, it's Hudson. I -- when I look at all of the factors, the timing of the turnarounds, the effects that we anticipate from just weak customer demand and the coronavirus, I think the stronger growth will be in the second half. Q2 will be better than Q1, of course, but not as strong as the second half. And it really is the second half where we'll see the bigger benefits from the plants coming online, some of the productivity programs that we're anticipating that we're working on and just the mathematical effect of the discrete items all hitting last year's second half. We'll get -- we get about 10 points of year-over-year EPS growth just because of the discrete events not repeating in the second half.

**Michael Joseph Sison** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Got it. And then in terms of FCC pricing, any thoughts there going forward? And just any general thoughts? Oil prices have collapsed. And I know you've talked about this in the past, but maybe just remind us what the effects are on Grace given the volatility in oil prices.

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

Sure. It's a great question, Mike. So let me start with pricing and then I'll broaden out. The -- in 2019, last year, we had a strong year for FCC pricing. We were above our 2 -- 1% to 2% range, north of 200 basis points of pricing last year. And our guidance for 2020 is consistent with our long-term expectations, 1% to 2% FCC pricing. Some years will be better than that, as we've said, some years, maybe not as good. But we expect that to be the long-term pricing growth in FCC.



## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

In terms of broadening out your question, refinery demand softened -- refined product demand softened in 2019. There was still growth. The global transportation fuel demand grew 0.8% in 2019, but that was down from 1.5% to 2% growth in the 2 or 3 years earlier, 2018 and 2017. And in North America, specifically, refinery production actually dropped 2% last year. Refineries were tightening up on inventories and responding to weaker economic conditions. Think about fewer trucks over the road, fewer ships on the oceans as trade patterns changed and so forth. Refinery margins dropped. They're at the low end of their 5-year range right now. And that's -- I think that contributes to the amount of turnarounds that we're seeing in Q1. We have seen customers extend the duration of their turnarounds. We -- I don't think we've seen a customer initiate a turnaround for this reason, but we have seen customers extend turnarounds.

But what does that mean for us? As you think about our business, we're driven -- our FCC catalyst demand is driven by 2 things: production levels of transportation fuel and increasingly, production levels of propylene out of FCC -- out of FCC units. And whether a refinery has weaker or stronger margins, as long as they're running, we're going to see that demand flow through to us. Oftentimes, a change in a refiner's margin profile will cause them to want to change their operating strategy or their catalysts, which always creates opportunities for us. We welcome those kinds of changes.

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### Operator

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

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

I was wondering if you can talk in a little bit more detail, you kind of mentioned the lower transportation fuel demand leading to some of the increased turnaround activity. But can you maybe talk about that in the context of IMO 2020 and maybe how that's impacting FCC and HPC demand? Any surprises on how IMO 2020 is playing out so far?

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

Thanks, Mike. If I step back and think about the transition into IMO 2020 and what we're seeing so far, I think there are 3 things that I would take note of. One is for our hydroprocessing business, the ART joint venture, we had an incredibly strong Q4 as customers were trying to be as ready as possible for the January 1 effective date. That is translating into a weaker first half of 2020 as customers sort of push their demand into 2019. But in the long run, IMO 2020 will continue to drive demand for our ART business. While the effective date has occurred, all of the capacity that refiners need to manufacture compliant fuel is not in place yet. And as we look out over the next 2, even 3 years, we see projects by our customers continue to add capacity, hydroprocessing capacity. It will continue to drive demand for our catalysts. That's the sort of the macro view, Mike.

At a more immediate perspective, our FCC customers, many of them have adjusted their operations to make sure that they're maximizing their margins given the changes in demand for different fuel types and given the relative margins for the different fuel types. I think for the most part, those adjustments have been made. Sorry, we're getting some keyboard in the background. But the -- I think for the most part, Mark -- Mike, those adjustments have been made. We have seen customers change the way they're operating their refinery. It's not a significant effect on us one way or the other. We want to make sure our customers are running their FCC units hard. That's the driver for us in our FCC business. And different customers have different strategies. Several times, we've been asked the question about some U.S.-based refiners and the strategies that they've talked about. Those are appropriate strategies for those refiners. But I wouldn't extrapolate them to the rest of the world. Not every customer can adopt those same kind of strategies.

And the third point I'd make, Mike, is what we're seeing internal to Grace in terms of our own logistics costs. We are not seeing any changes in fuel costs being passed through by our shipping partners. And I think what's -- our read is that the upside effects of IMO 2020 are being mitigated by weak demand more broadly.



FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

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

All right. And then I wanted to ask a question on the materials business. Can you touch on what you're seeing in the coatings space? I think a lot of your architectural customers or the architectural coatings companies that we look at are expecting actually a better start to the first half of the year, presuming that weather is more normal than it was last year, but it sounds like you're looking to work down inventory levels. So can you just reconcile the outlook there?

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

Sure. It's a good question. We -- so architectural is a small part of our coatings business. The much bigger part is industrial coatings and consumer durables, like furniture and white goods. That's really where our coatings business is exposed.

**Operator**

And our next question comes from Ben Kallo with Baird.

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

Hudson, could you just break out, I think, the impact that you're seeing on the coronavirus by the different segments? And then my second question is just on the overall, you mentioned diesel, I guess, weakness. And how much do you think that has to do with fuel standards in Europe and everything going on with diesel gate in that?

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

Sure, Ben. In terms of the coronavirus effects, I think the effects in the refining business will be very small. We -- our sales into China of FCC catalysts are literally 0. And I don't think there are significant effects on customers outside of China, assuming this doesn't tip into a broader recession. And so in FC and MT, both of those businesses have sales in China of about 8% to 9% of their total sales, and they also supply customers that are manufacturing outside of China for export into China. And so I think the effects that we'll see will be more significant in FC and MT, less significant in RT. And I'm sorry. Oh, and you asked about diesel. So the -- I think from the data that we see, we think the biggest effects on diesel demand are really driven by economic activity rather than regulatory change.

**Operator**

(Operator Instructions) And our next question comes from Laurence Alexander with Jefferies.

**Adam Samuel Bubes** - *Jefferies LLC, Research Division - Equity Associate*

This is Adam Bubes on for Laurence Alexander today. I was wondering in the Materials Technologies business, we saw sales volumes improving in North America and APAC sequentially. Have you seen any sort of positive inflection point in these geographies?

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

The -- Adam, thanks for that question. The growth that we're seeing in North America is really driven by 2 things. It's driven by our pharma business, our consumer/pharma business, where we've had great results; and it's driven by our colloidal business. The colloidal business is 1 of the big 3 new capacity additions that we've talked about earlier on the call. And so that's where the drivers are in North America.



## FEBRUARY 04, 2020 / 2:00PM, GRA - Q4 2019 W. R. Grace & Co Earnings Call

In Asia, China had been weak for us for, oh, gosh, 4 quarters. And in Q4 -- Q3, we started to see a little stabilization. And in Q4, we saw a solid improvement in China. It's what you're seeing in your numbers. I think that will be arrested somewhat because of the outbreak of the coronavirus. But I'm optimistic that once the effects of the virus have passed through that, that underlying economic strength is still there.

**Adam Samuel Bubes** - Jefferies LLC, Research Division - Equity Associate

Got it. That's really helpful. And then my last question, I was wondering, can you just give a little more detail on the M&A landscape? And are there any areas you used to be interested that are less interesting now?

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

The -- for us, we think about opportunities in both the catalyst business and the Materials Technologies business. There was a question earlier on the call, I think it was McNulty that asked it, about the process that's going on right now with Lummus. We're not going to comment any more specifically on that. Although I'll acknowledge we have said many times in the past, we've commented many times in the past about our interest in CLG. We have said that we're not interested in all of Lummus.

In the Materials Technology side, we've spent a lot of time in that business over the last year looking at opportunities. It's an area of interest for us. When we look at the adjacent addressable markets, we see attractive growth opportunities and attractive profitability opportunities, and I expect us to continue to spend time in that area.

**Operator**

Thank you. And this concludes our Q&A session. I will now turn the call back to Jeremy Rohen for any further remarks.

**Jeremy F. Rohen** - W. R. Grace & Co. - VP of Corporate Development & IR

Thank you, Sydney. Thank you, everyone, for your time today and your interest in Grace. We look forward to seeing many of you on the road over the coming months. Thank you.

**Operator**

Ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.

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