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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2019 W.R. Grace Earnings Conference Call. (Operator Instructions) I would now like to introduce your host for today's call, Mr. Jeremy Rohen, Vice President of Corporate Development and Investor Relations. Mr. Rohen, please go ahead.

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

Thank you, Sherry.

Hello, everyone, and thank you for joining us today for Grace's Second Quarter 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. 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 will 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 our earnings materials and posted on our website. This morning, Hudson will address our second quarter business performance and recent events impacting our third quarter and full year results. Bill will cover our second quarter consolidated financial results and provide an update on our outlook. We will then open the call for your questions.

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

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

Thank you, Jeremy. Good morning, everyone.

Our team delivered a solid second quarter with good sales and earnings growth. We made significant progress with our commercial and operating excellence initiatives and our strategic growth investments. For the quarter, sales and adjusted EBIT were up 6% and adjusted EPS was up 8%. Catalysts Technology sales were up 9%, and operating income was up 10% on strong organic volume growth and improved pricing.

For the first half, Grace's sales and adjusted EBIT were up over 7% and adjusted EPS was up 10%, in line with our plan for the full year. Across the company, our commercial excellence investments are creating value and our focus on value selling continues to produce results.

In the quarter, pricing improved 270 basis points with gains in every business. FCC catalyst pricing improved well over 200 basis points for the trailing 12 months and momentum remains positive.

Our operating excellence investments are also creating value. Since Q3 2017, we've made onetime investments of $17 million in our Grace Manufacturing System, or GMS and have already realized over $15 million in annual earnings benefits, primarily from higher production volumes at sold-out plants due to increased throughput and reliability. We've completed GMS implementations at 5 of our biggest plants and started the sixth implementation last quarter. The rollout to our remaining 15 sites will occur over the next 2 to 3 years with minimal additional investment.

Based on our success today, we've upgraded the expected annual benefits of GMS from 50 basis points to 75 basis points. Some of this will drop to the bottom line, but most will be reinvested to support future growth. I remain very confident in our long-term growth outlook, the value of the capital and operating investments we are making and the strong strategic position of our businesses. The recent events, we'll talk about next do not change that.

Please turn to Slide 5.

We recently experienced 3 discrete events that will negatively impact our Q3 and full year results. We expect these events will reduce full year sales by about 2% and have a net impact to earnings of between $15 million and $17 million. Most of the sales and earnings impact will affect Q3 results and most of the actions to offset the impacts will be seen in Q4 results.

First, a North American FCC catalyst customer experienced an explosion and fire at their refinery, June 21, as we communicated that day. The customer has filed for Chapter 11 bankruptcy protection and indicated they will not resume refinery operations. We immediately began commercial efforts to replace the lost volume and expect to see results beginning in 2020 given the sales cycle for FCC catalyst technologies and our continued focus on value selling. We also immediately adjusted our manufacturing operations to address the lower demand expected for the balance of this year.

Compared to our prior outlook, we expect this event to reduce our second half earnings by about $12 million, reflecting lost margin, the costs of adjusting our manufacturing operations and the potential write-off of our accounts receivable.

This is an insured business interruption event, and we have begun discussions with our insurer. It is too early to know the exact amount and timing of the insurance recovery. We've included our current estimate of insurance recovery for 2019 in our updated outlook for this year.

Second, in Specialty Catalysts, a major customer informed us they are temporarily, but significantly reducing production of one of their product lines in response to the decline in global automotive production. This customer-specific inventory correction will result in a meaningful decrease in catalysts sales and production in the second half of the year. Compared to our prior outlook, we expect this event will reduce full year earnings by about $9 million. We've also adjusted our manufacturing operations to address this change in demand. As a note, we estimate about 7% to 8% of Specialty Catalysts sales go into automotive end uses. So this customer inventory correction is a significant change, but in a small end market for us.

Finally, in Materials Technologies, we experienced an equipment failure that resulted in a disruption to one of our silica manufacturing plants that will reduce earnings in the second half of the year by about $8 million, including cost to correct the failure and higher costs incurred to serve customers and minimize any impact to their operations. Operations are now restored and the affected plant is fully back online. Although GMS was not yet implemented at this plant, the GMS disciplines and problem-solving approaches helped us minimize the cost and downtime caused by the incident.

We have taken decisive actions to offset the operational and financial impact of these events. Most significantly, we have eliminated $11 million in operating costs, including headcount reductions, deferred hiring and other spending reductions. Our team has responded very quickly to these events. They do not change our strategic direction or my conviction about the earnings power of our businesses, nor do they change my confidence in delivering our 5-year financial framework.

Now let's turn to Slide 6 and look at our second quarter business performance. In Specialty Catalysts, organic sales were up 11%. We saw strong demand for our catalysts and licensing technology as customers seek to maximize the value of the resins they produce. We have received some questions from investors about the polyolefins market. At this point, we have seen no significant changes in aggregate customer demand other than the customer-specific inventory correction mentioned earlier. We are closely monitoring demand and inventory levels to ensure we are able to react quickly to any future change. Our commercial excellence and operating excellence practices help ensure we are well prepared to take action if necessary.

For polypropylene licensing, this month, we announced our third UNIPOL license of the year and expect to announce a fourth license in the coming days. We have a robust pipeline for our UNIPOL process technology reflecting strong long-term demand for polypropylene and for our process and Catalysts Technologies. We remain upbeat about the growth opportunities in the licensing business and the benefits it will bring to future polypropylene catalyst sales.

In Refining Technologies, sales were up 6% on good volume growth and strong pricing. FCC catalyst pricing momentum continued and for the trailing 12 months improved well over 200 basis points. The business remains on track to deliver greater than 200 basis points of improved price for the full year.

ART continues to see strong demand for HPC catalysts, and we expect this to continue as the demand for cleaner fuels increases and IMO 2020 is fully implemented. We have seen a delay in sales volumes in ART due to timing of startups and catalyst deliveries and expect Q4 to be a very big quarter as we work with our customers to be fully ready for IMO 2020 implementation.

Let's turn to Materials Technologies on Slide 7. In Materials Technologies, Q2 sales were down 3% on a very tough compare. Q2 2018 was a record sales, margin and earnings quarter for MT. This quarter, sales were up 2% on a constant-currency basis, primarily from improved pricing. Sales volumes were up slightly on continued strength and consumer pharma end markets that offset weakness in the coatings market and order timing in chemical process markets. Year-to-date, MT sales increased 5% on a constant-currency basis. Sequentially, gross margins and earnings were essentially flat and in line with our outlook from Q1. We continue to experience good overall demand for our MT products, led by consumer/pharma but are seeing some slowdown in demand in the global coatings markets, the Asia-Pacific region and certain plastics end markets. In these end markets, order rates have slowed, but we have seen no signs of an inventory correction developing.

The Materials Technologies team continues to execute its strategy of focusing on faster-growing, more strategic markets to drive volume growth and margin expansion. These more attractive end markets are expected to contribute 2/3 of the businesses sales growth in the future.

In May, we announced that Bill Dockman had been elected Grace's Senior Vice President and Chief Financial Officer. Many of you met Bill during Q2, at one of the investor conferences or NDRs. He is a trusted partner, and I'm delighted to have him as our CFO. I'll now turn the call over to Bill, who will discuss our financial results and outlook in more detail.

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

Thanks, Hudson.

Turning to Slide 10, let's begin with our second quarter results.

Second quarter sales as reported were $514 million, up 6% and up 8% on constant currency. Top line growth was driven by higher sales volumes and improved pricing in all our businesses. This more than offset $11 million of currency headwinds due to the continued strength of the U.S. dollar versus the euro.

Adjusted gross margin for the quarter was down 40 basis points year-over-year, primarily due to a very tough compare in MT. Sequentially, adjusted gross margin was up 130 basis points, driven by higher sales volumes. Adjusted EBIT was up 6%, adjusted EBIT margin was up 10 basis points year-over-year and up 250 basis points sequentially. Earnings for our ART joint venture were down $2 million year-over-year. Adjusted EPS for the quarter was $1.16 per share. Year-to-date, adjusted free cash flow was down $42 million due to higher CapEx spending and timing of working capital changes compared to the prior year.

Now let's turn to Slide 11.

We remain focused on executing our disciplined capital allocation plan to support our organic growth initiatives, pursue bolt-on acquisitions and create shareholder value. In the second quarter, we invested $46 million of capital into our plants and are on track to invest between $200 million to $210 million in 2019. Our capacity investments are timed and sized to meet identified customer demand. To this point, over 90% of our current growth capital investments are tied to specific customers, contracts or licenses providing a strong line of sight to the demand to support these investments.

In June, we announced a small bolt-on acquisition in Refining Technologies. We acquired Rive Technologies business, including its unique zeolite technology that improves the performance of traditional FCC catalysts, especially in the polypropylene max applications. This is a good example of a type of tuck-in acquisitions that help drive our long-term strategies.

In the quarter, we returned $43 million of cash to shareholders through our cash dividend and share buybacks, bringing our total returns year-to-date to over $66 million. At the end of this quarter, our net leverage was 3.2x, up 0.1x from Q1 due to the acquisition. We remain committed to our target net leverage range of 2 to 3x. We've prioritized the use of excess cash reducing net leverage over increased share buybacks. With that said, we remain open to additional strategic acquisitions when compelling bolt-ons are available.

Moving to Slide 12, let's look at our revised 2019 outlook.

For the full year, we expect year-over-year sales growth be in the range of 4% to 5%, down from 6% to 7% in our prior outlook. At the segment level, we continue to expect 2019 year-over-year sales growth for Specialty Catalysts in the high single digits and for Refining Technologies in the low single digits. For Materials Technologies, we now expect low single-digit top line growth.

For the full year, our revised EPS outlook range is now $4.35 to $4.43 per share, down from $4.53 to $4.62 per share. And our adjusted EBIT outlook range is now $475 million to $483 million, down from $490 million to $500 million. The $15 million to $17 million of lower earnings includes the expected savings from cost-reduction actions and proceeds from insurance recoveries in 2019.

From a timing perspective, we believe most of the adverse effects of these impacts will affect Q3 results, while most of the cost-reduction actions and insurance recoveries will likely benefit Q4. We expect third quarter adjusted EBIT will be down 15% to 19% year-over-year. Our adjusted free cash flow range of $235 million to $250 million remains unchanged from our prior outlook. We expect full year inflation to be about 100 basis points, with the low end of our prior inflation outlook of 100 to 150 basis points. However, we now see greater headwinds from FX in the second half with the continuing strength of the U.S. dollar.

With that, please turn to Slide 13, and I will turn the call over to Hudson for closing remarks.

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

Thank you, Bill.

We had a strong second quarter and first half. It's disappointing that the 3 events will negatively impact our results in the second half. Our team has acted with a strong sense of urgency to offset the effects of these events with cost reductions and other actions. These events delay our progress, but they do not change our direction or our goals. Grace is a resilient company. We are not immune to changes in the global macro environment, but the end market and regional exposures we have are well diversified and/or very stable. We have low exposure to emerging market currencies and almost no direct exposure to U.S./China tariffs. Just as important, when things do change, we have a strong track record of quickly adjusting and taking action where needed.

With that, let's open the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from John McNulty with BMO Capital Markets.

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

So if we look at the catalyst customer outage, it looks like on an annualized basis it would be about a $24 million kind of hit. I guess as we look to 2020, admittedly it's far away, but you're taking the actions to try to, I guess, find homes essentially for that catalyst. I guess, how much of that do you think realistically you can make up as we look to 2020?

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

John, it's Hudson. Thank you for the question. Let me just build out a little bit of color on the $12 million. In that $12 million, there is loss margin on sales that won't occur this year. There are some costs that we've incurred to adjust our manufacturing operations, and there's a write-off of the -- an assumed write-off of the receivable from them once they file bankruptcy.

And so the $12 million that you're seeing isn't all margin that needs to be replaced through new selling activity. Maybe half of it is margin that needs to be replaced by new selling activity. It will take some time. We want to maintain our focus on value selling. I expect benefits beginning early in 2020 from the new sales efforts we've undertaken. Over time, our intention is to maintain our market share in this business, as we've talked about before, and it will take a couple quarters to restrike that balance, but it won't take as much as a year or anything like that.

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

Got it. No, that's hugely helpful. And then just as a follow-up. On the Materials Tech weakness, it sounds like some of it, obviously, North American coating season was a bit of a disaster given all the wet weather and same even with Europe. I guess have you started to see trends improving in some of the areas where you'd kind of seen the weakness in the second quarter, or is it a little bit early for that?

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

Yes. This is something that we saw starting to develop in Q4 for us, mostly in Asia. And we saw some stability relative to Q4 and Q1. It looks like things had stabilized, got a little weaker in Q2, but nothing significant. So this is more about year-over-year weakness than sequential changes in weakness if I can summarize it that way.

Operator

Our next question comes from Christopher Parkinson with Crédit Suisse.

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

You've seen some of your key raws ease into the second half and although some are naturally hedged directly or indirectly, can you just comment on what you're seen overall in your COGS basket procurement and then just reconcile that with the price trends so we just get better sense of the gross margin outlook?

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

You bet, Chris. So for us, cash costs on our raw materials peaked in Q1 and raw material costs have moderated a little bit since then. It's not significant. I think Bill commented. We've got full year inflation would be between 100 and 150 basis points when we gave our initial expectations back in the beginning of the year. We're seeing a closer to about 100 basis points now. And most of what that is, is we thought we'd see some higher costs, Q2, Q3, Q4, but it looks like now that Q1 is going to be the top for us.

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

Got it. And just a quick follow-up. Just on the pricing side and Cat Tech, you've been doing pretty well. It's been -- obviously, you've had several quarters of just in excess of 200 bps on a TTM basis. Can you just talk about the discipline that you're seeing in the industries? Is that still doing well even with the economic malaise? And just give us a little color on how others are acting?

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

Yes. Great question, Chris. So I'll take this as a refining catalyst question. And FCC catalysts, the -- we like the environment that we see. The demand for transportation fuels has been good. Production rates and utilization rates for the different competitors seem to be in line with historical levels. And so that's been constructive for us. On the hydroprocessing catalyst side, we've seen -- we look at it as margins because of the metals pass-through, but we've seen an improvement in margins in our hydroprocessing catalyst business that reflects the strong demand in those products.

Operator

Our next question comes from Kevin McCarthy with Vertical Research.

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

Appreciate all the color you've provided on the 3 discrete items. I was wondering if you could parse it into the expected impact on the third quarter, specifically, and kind of bridge us to the decrement that Bill referenced in his prepared remarks.

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

Sure, Kevin. It's -- the vast majority of these negatives are going to hit Q3. And if you think about each piece, for the FCC catalyst customer, there's obviously a part that's lost sales in Q3, but we also have the costs of the manufacturing adjustment and the receivable that we expect to write-off in Q3. On the SC customer inventory, again, most of that change is volume that was expected in Q3, and there are some costs in there that we'll incur to keep our manufacturing operations in line. For the MT, the manufacturing disruption in Materials Technologies, this happened in Q2. There were costs that we incurred in Q2 about $2 million, but most of the costs got capped -- inventory accounting got capped up in Q2 and then will flow through Q3. And so those are the different pieces, Kevin. If you think about the cost reduction actions, we began taking action as soon as we -- as soon as these events occurred. Some of those actions have immediate effect. Most will take some time to get fully implemented, and we expect most of the benefits to occur in Q4. And then our current expectation on the insurance recovery is that it will be 100% Q4. It's going to take us some time to work through all of this with the insurance company.

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

Okay. And then just wanted to ask you about the Specialty Catalysts customer inventory correction. Was that in polypropylene or a different resin? Maybe you could talk a little bit about which region of the world that was in? Or whether it was multiple regions? And your customer concentration in that product category?

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

This was one of our largest customers, and they made a decision to significantly reduce the production -- their production on this product line in response to high inventory levels that they were experiencing. And Kevin, I'm not going to be able to add more color. I'm not going to be able to share any customer confidential information.

Operator

Our next question comes from John Roberts with UBS.

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

It sounds like IMO 2020 is going to provide a very strong finish to this year. Is it too early to tell whether things will drop off in early 2020 for you? Or do you think the strong fourth quarter is going to carry forward into the first quarter?

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

John, thanks for that question. I think that the momentum carries into 2020. And if you think about the dynamic that's happening with our customers, you have one set of customers that have been operating hydroprocessing equipment for a while. Those units are running hard. They didn't have to make new investments to capture the benefits of IMO 2020. Call those are run rate customers where we've seen strong demand for a long time and I expect that to continue. Then there's another set of customers that have made investments to take advantage of IMO 2020, and those customers are busy this year and some of it will be next year, bringing online new equipment that allows them to take advantage of the new fuel specs. And so some of those customers are finishing up those projects this year. We expect to deliver catalysts to them this year. For the projects that finish up next year, we would expect catalysts -- we would expect to deliver catalysts to them next year. So they will be strengthened both years as our customers fully position to take advantage of this.

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

And then secondly on the MTO catalyst business in China. I know it's a small, but there are still several more MTO startups, I think, going on this year and into next year. And so I would expect that volume demand is pretty good volume for MTO catalysts. There is just a profitability problem given the MTO profitability and I don't know if you have a lot of Chinese competition there as well?

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

Yes. Your instincts are right, John. This was a market that we judged to be quite attractive a few years ago. We made some investments, developed some products and entered the market. And frankly, enjoyed a couple pretty good years. But since then, the market has gotten a lot more crowded. The profitability isn't what we wanted to be, and so we made the decision to shut down those operations and take those dollars and reinvest them someplace else.

Operator

Our next question comes from Bob Koort with Goldman Sachs.

Robert Andrew Koort ***Goldman Sachs Group Inc., Research Division - MD***

I was just wondering on the Philadelphia energy issue. Is it certain that, that refinery won't be restarted? And then secondly, thinking about replacing those volumes elsewhere. How easy is it to do that? I guess I get the sense that a lot of these catalyst contracts are very specific to the units you sell into. So I'm just wondering how easily you can pivot or displace, maybe a competitors sales at another refinery to offset that loss.

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

Thanks, Bob. The -- and I'm just going to share what's been publicly communicated. In PES's bankruptcy filing, they did talk about an objective of trying to restart that refinery or maybe sell that refinery to somebody else that would restart it. But that would only occur after a cleanup and reconstruction. And so for our planning purposes, we're assuming no volume from that location this year or even next year.

And to the second part of your question, it does take some time to sell the right catalyst technology to a customer. But we're constantly engaged with customers and potential customers. As we learned about the refinery incident, one of our immediate reactions was, okay, let's start building a pipeline with customers to replace this volume. It takes time. It is a technology sale, as you noted. I expect little, if any, benefit this year. But by the first half of next year, I would expect to see the results. The sales cycle was somewhere between 6 and 12 months depending on the customer and the amount of technology testing that they want to do. It's important to note for everybody, none of this changes our focus on getting value for the technologies that we sell or our focus on the pricing momentum that we have.

Robert Andrew Koort ***Goldman Sachs Group Inc., Research Division - MD***

Great. And if I could follow-up on IMO. Sounds like you are seeing some of that business start to come inside. As you see those changes and the shifts you're seeing to help meet those specs, has it changed your view on how the industry is going to meet IMO 2020, whether it's changes in the fuel mixture or whether it's putting scrubbers on ships? Has that evolved at all through the year or changed how you think the compliance is going to be met there?

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

I think, thematically it's all consistent with earlier views. We're not seeing any changes in customer behavior that are directionally different than what we would have thought at the beginning of the year. There's timing about how fast scrubbers will be put in place. There's timing, as I commented on John's question, there's timing about how fast equipment will come into service and things like that. But I think that's more about timing than direction.

Operator

Our next question comes from Mike Harrison with Seaport Global Securities.

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

Maybe just continuing on this discussion about IMO 2020 and the expectations of ART having a very strong Q4. Just wondering, what your confidence level is around potentially some of that demand slipping into 2020. And if that is the case, I mean, would that just be related to timing and delays or do you feel like there maybe is some change in how they're viewing the regulation playing out?

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

Thanks, Mike. I -- there's no change in how the regulation is going to play out in our view, and we've seen no hesitation with our customers in terms of moving forward with their plans. And so there is some timing here, as we commented in the prepared remarks. We've seen some volume shift from Q2 into Q3 and Q3 into Q4. It's made Q4 a little bigger in ART than we had thought at the beginning of the year. But we've got pretty good visibility into where our customers are with their projects. And so our best visibility into that is reflected in the thinking -- in this morning's update.

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

All right. And then I wanted to ask also on the catalyst gross margin number. You were up a little bit year-over-year. But I guess, with pricing up, Takreer being fully up and running and potentially helping mix and utilization. Can you help us understand why that catalyst margin number couldn't improve a little bit more?

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

I've focused on it sequentially, which is really where you would start to see the benefits of the most recent pricing activity and the startup of Takreer. And I don't have it in the top of my mind. And Bill just gave me a note. Bill, help me with the sequential improvement in catalyst gross margins.

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

Yes. I think another factor in Q2 that held the margin back a little bit. We did have a turnaround at one of our Specialty Catalysts plants and that had a little bit of a one quarter negative effect on margins as well.

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

Thank you, Bill. But margins were up strongly sequentially 150 basis points, which reflects the progress we made with pricing, the customer coming back online that you referenced, offset a little bit by the turnaround we had in Q2 that Bill referenced.

Operator

Our next question comes from Mike Sison from KeyBanc Capital Markets.

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

When you think of the 3 discrete items. Is it possible to get a lot of that business back, I guess, or replaced or moved into other areas by 2020?

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

I would expect most of it to come back in 2020, Mike. And let me give you some color on that. On the FCC side, we'll get all of that volume back in 2020. It would just be a question of when. But I would expect first half. On the MT, on the manufacturing plant disruption, there was really very little volume loss. It was -- we incurred some extra cost to make sure we kept our customers hold, a little volume loss. On SC, the customers -- inventory correction is temporary. We expect them to resume manufacturing next year, and we would expect them to begin buying catalysts from us again. Another point that I'll make at this juncture is, we will have insurance recoveries in 2020 as well. And so if there's any gap in the recovery from a commercial perspective, we'll get additional insurance benefits in 2020.

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

Right. Great. And then maybe as you think about FCC catalyst, can you maybe walk us through, kind of, like the underlying growth in the industry as you head into 2020. They're probably new plants, new opportunities that could help support some of the growth next year?

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

Sure. So FCC catalyst is a -- the demand drivers or the growth drivers are demand for transportation fuels and demand for polypropylene coming out of refinery units and the demand for transportation fuels grows 1% to 2% a year. It's actually a very stable demand pattern if you look over many years. Even if you look back in the '08/'09 recession, demand for transportation fuels is a pretty robust demand series. And so we would expect that level of demand to continue into next year. Demand for polypropylene at our refinery units has been growing, and we expect it to continue to grow. Our expectation is that it adds at least 1 percentage point in growth to the demand for FCC catalysts. That keeps us in the low single digit for volume growth in FCC catalysts. And we see that stable next year. On hydroprocessing catalysts, that demand is driven in small part by the demand for transportation fuels, but to a much greater extent by the demand for clean fuels. You all well know, and IMO is a important part of that, especially this year and next year. But whether it's IMO or another increasing clean fuels regulation, that provides strong support to demand for hydroprocessing catalysts. We've said high single digits and that business has been tracking to that for a number of years, and I think it will next year too.

Operator

Our next question comes from Chris Kapsch with Loop Capital Markets.

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

I had a follow-up on the pricing dynamic and I guess, focused on FCC catalyst. I'm just wondering, if you could just -- I'm assuming that the restart of Takreer would have given that, that refinery's configuration was skewed towards propylene maximization. I'm assuming that, that had a little bit of beneficial effect on the pricing dynamic. I'm wondering if you could just parse out on an apples-to-apples basis if there's way to look at that? What the pricing comp might look like? And I had a follow-up.

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

Chris, I -- without telling you about the economics of a specific customer, I'm not sure I can do that. But I will tell you that the sequential improvements in pricing and margins were only in part due to that one customer. We are making good progress with many customers, and I'll probably just leave it at that, Chris.

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

Okay. And then Hudson, you commented on sort of efforts to, I guess, fill the void that could be left from this, if this refinery shutdown in Philadelphia is permanent you would attempt to do that without affecting the overall effort to get value for your FCC products. But I'm just -- maybe you could provide more color on that? And also just curious like ultimately demand for refined products is healthy, the global complex is kind of a zero-sum game. So presumably if that refinery is down, there's other refineries that are picking up slack in terms of diesel fuel and gasoline and so forth. I'm just wondering I mean shouldn't you be just naturally picking up some additional catalysts sales to other neighboring adjacent refineries? And is that factored into your assumptions at all at this point?

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

Yes. No, Chris, Your analysis is exactly right. The demand for transportation fuels on the East Coast didn't change because of this event. And so that fuel is being supplied by other refiners, either in the region, may be brought up from the Gulf Coast, maybe even imported from Europe. And so we do have customers. We have other customers in the East Coast. We have customers on the Gulf Coast and in Europe, of course. And so there is a little bit of a natural offset that happens as those customers pick up the -- or fill the production gap, but we obviously don't have 100% share. And so as we look to balance our share, it drops initially in a situation like this, recovers a little bit as customers fill the -- other customers fill the gap, as you noted, but wouldn't recover fully unless we picked up additional volumes at other customers.

Operator

Our next question comes from Paretosh Misra with Berenberg.

Paretosh Misra ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

In terms of losing this North American FCC catalyst customer, what is it due to your mix, like the product you were selling to them, were they very high end or maybe middle of the pack?

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

I appreciate the question. I don't think there is any significant change in mix. They were buying a good value technology for us, but they were mostly manufacturing for transportation fuels. So a balanced, good customer. It's sad to see this. They were a highly valued customer.

Paretosh Misra ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

Got it. Understood. And then the second, and I apologize if you already covered that in prepared remarks. But can give us update on the hydroprocessing plant at Lake Charles? What's the current status? When do you think it will start making an impact on your revenue?

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

Sure. We're on track for mechanical completion at the end of this year. And so no financial benefit this year, but we do expect the plant to start up next year early next year. And with sales and volumes coming as soon as it starts up, it's -- those volumes are identified. The selling activities are -- most are already complete, and we expect the plant to startup with good utilization.

Operator

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

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

This is Dan Rizzo on for Lawrence. Just in -- within the Materials Technologies, you mentioned that consumer/pharma, you were seeing some strength there I was wondering if that was -- because you're taking new contract wins, you're taking share because all -- other companies are suggesting within that space that things have been a little soft for at least for the second quarter going into the third?

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

Dan, I appreciate the question. This is -- I don't think any of it, certainly not any material part of it is with new customers. I think it's existing customers ramping up production of their products.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Okay. So I mean, so that's increased penetration as opposed to just general market strength or I mean any...

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

Well, I mean, some of it is just the market. It's -- this has been a nice growing market for us, but we're outperforming the market. But -- and I think that's primarily with customers ramping up production of existing products that we've been on already.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Okay. And then I think you just mentioned the chemical processes, there were some order timing issues that would suggest that you're going to make that up in the third quarter then or later in the year?

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

Or some of it. We had a strong first half. This is primarily in adsorbents. We had a strong first half. Q3 won't be quite as strong as the first half and then a little bit of recovery in Q4.

Operator

Ladies and gentlemen, as I'm showing no further questions in the queue at this time, thank you for joining our question-and-answer session. I would now like to turn the call back over to Mr. Jeremy Rohen for any closing remarks.

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

Thank you, Sherry, and thank you, everyone, for your time today and your interest in Grace. We look forward to seeing you in the quarter.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may all disconnect and have a wonderful day.