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GRA - Q3 2014 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 3Q14 sales of \$856m and adjusted EPS of \$1.07.



CORPORATE PARTICIPANTS

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PRESENTATION

David Joseph - W. R. Grace & Co. - Finance Manager, IR

Joining me on the call are Fred Festa, Grace's Chairman and Chief Executive Officer; and Hudson La Force, our Chief Financial Officer. Our earnings release and corresponding presentation are available on our website. To download copies, go to grace.com and click on Investors. Links to the earnings release and slide deck are available under the Quarterly Results section.

Some of our comments today will be forward-looking and are made under Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results may differ materially from those projected or implied due to a variety of factors. Please see our recent SEC filings for more details on the risks that could impact Grace's future operating results and financial conditions.

We will 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. These comments on forward-looking statements and non-GAAP financial measures apply both to prepared remarks and to the Q&A.

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

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

Good. Thanks, David. And good morning to everyone and thank you for joining us. You know, the headline for me was we had a very good quarter. Our sales grew 11% and earnings grew 27%.

All three businesses achieved solid sales growth and strong margins. And, as important, our cash flow grew 14% year to date. The third-quarter results gave us the confidence to narrow our earnings outlook and increase our cash flow forecast. We expect 2014 adjusted EBIT to be in the range of \$625 million to \$630 million, and we expect adjusted free cash flow to be \$430 million or more.



Over the past couple of weeks, investors have asked how the lower price of crude oil will impact our catalyst business. We believe the recent drop in crude oil prices will have no significant effect. Our business is driven by end-user demand for transportation fuels and plastics.

Generally, lower feedstock costs -- including lower crude oil prices -- are good for end-user demand. Volatility and feedstock costs has little, if any, effect on our catalyst volumes or prices.

Let's take a look at our catalysts technologies business. Overall, catalysts results were better than we expected, with strong growth in all three product groups. FCC catalysts grew 10%, specialty catalysts grew 8% before the UNIPOL acquisition, and sales in our ART hydroprocessing catalysts joint venture grew double digits.

Adoption of our new FCC catalysts introduced over the last year has been very good. We are ahead of our sales plan for these products and expect them to account for over 10% of the FCC catalysts sales this year. As you will recall, these products were developed to help our customers meet the specific requirements of processing shale feeds, heavier feeds, and maximizing propylene production.

The quick adoption of these products underscores our ability to commercialize the right technologies to meet our customers' changing requirements. These new products also helped us to return to our historical FCC catalyst position in the third quarter, about one quarter earlier than we expected. Our joint venture in ART had a much better quarter, with good growth and solid earnings. We addressed the issues we experienced earlier this year, and we expect strong quarter-four results in the joint venture.

Shifting gears to materials technologies, sales grew 4%, led by 7% sales growth in engineered materials. We saw good growth in North America and Asia, but sales were weaker in Europe beginning in August. European market demand has slowed, and we expect it to continue to slow in the fourth quarter. In this environment, we are focused on driving growth in the faster-growing markets, where we have introduced new products; and reducing costs where growth is slow.

Construction products also had a good quarter, with sales growth of 7% and gross margins of almost 37%. Cement and concrete chemicals grew 9%, with double-digit growth in North America and Asia. Sales of nonresidential building materials grew 10%. We saw a pickup in commercial and infrastructure starts during the quarter, offsetting the project delays we saw in Q2.

We are pleased with the growth we are achieving in both SCC and nonresidential building materials. We are growing at or better than the market, with good margins and good earnings leverage. Our North America residential building materials business has performed below our expectations this year. We are working with our channel partners to reposition this business to take advantage of growth opportunities in the future.

Grace is well positioned as we exit 2014. I'm excited about the investments we are making to protect and nurture our high-growth opportunities. It is also clear that the global macroeconomic climate will remain challenging. We'll continue to manage our business to maximize performance in ROIC. With that, I'm going to turn it over to Hudson for some more specifics.

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

Thank you, Fred. Please turn to pages 4 and 5, and we'll start with a quick review of Grace's overall results for the quarter. Sales were \$856 million, an increase of 11% from last year. Segment gross margin was 38.6%, an increase of 170 basis points.

Adjusted EBIT increased 27% to \$181 million, and adjusted EBIT margin increased 270 basis points to 21.1%. Adjusted EBIT ROIC was just under 30% and on track to exceed that level by year-end. Adjusted EPS was \$1.07 based on diluted shares of \$75.6 million.

Let's turn to catalyst technologies on page 6. Third-quarter sales were \$329 million, up 20% from last year and up 9% ex-UNIPOL. Gross margin was 42.5%, up from 39.2% last year.

The higher gross margin primarily was due to higher-margin polypropylene catalyst and licensing sales and better manufacturing costs. Segment operating income was \$101 million, up 30%. Our SC catalyst business has a strong correlation to end-user demand for transportation fuels on a global basis.

We also have a positive correlation to FCC unit utilization rates and an inverse correlation to feedstock quality. We see little, if any, direct impact from absolute prices or refinery margins. In the last five years, crude prices have moved between \$100 and \$80 per barrel multiple times, with no discernible effect on our catalyst volumes or prices.



From a commercial perspective, changing market dynamics create opportunities for us. When our customers see shifts in their business, they expect us to help them find solutions. The success of the new products we introduced last year demonstrates our ability to leverage our technology to provide our customers with the products they need to optimize their results.

Said differently: we are long change and complexity much more than we are long oil. And we expect change and complexity to be a constant in the markets we serve.

Let's move to materials technologies on page 7. Third-quarter sales for materials technologies were \$229 million, an increase of 4% from last year. Sales of engineered materials increased 7% due to higher sales volumes, favorable currency translation, and improved pricing.

Sales increased double digits in North America and Asia, more than offsetting weakness in Europe and Latin America. Sales in the coating end uses, our largest end-use segment, increased 12% in the quarter. Segment gross margin increased to 35.3%, driven by improved pricing and investments and manufacturing productivity and energy efficiency. Segment operating income increased 4% to \$49 million. Segment operating margin was 21.3%.

Please turn to page 8 for construction products. Third-quarter sales for construction products increased 7% to \$298 million. Sales volumes increased almost 5%, and pricing improved 3%. Sales of specialty construction chemicals increased 9%, with strong growth in North America and Asia.

Sales of specialty building materials increased 5% overall. Sales into commercial and infrastructure applications increased 10%, but sales in our North America residential business declined during the quarter. As Fred mentioned, we are working with our channel partners to reposition this business for better growth. This effort began in Q2 and will be complete in Q4.

Segment gross margin increased 50 basis points to 36.8%, primarily due to higher sales volumes and improved product mix. Segment operating income increased 7%. Higher operating leverage from our growing SCC and non-res SBM businesses was partially offset by lower sales in residential SBM.

Let's touch on a few corporate items and then our outlook. During Q3 we settled the personal injury deferred payment obligation, or PI DPO, and consider this a significant positive for Grace. The original terms of the PI DPO called for a total of \$1.55 billion in payments from 2019 through 2033. We settled the obligation for \$632 million, representing a discount rate of 9.2%. Compared with our 5.25% financing rate, this represents a pretax cash savings of \$250 million over the life of the PI DPO. In addition, the settlement simplifies our capital structure and eliminates the unusual non-cash interest accretion we have been reporting since emergence.

Finally, the settlement adds to our NOL and extends our low cash tax rate into 2021. The settlement was the primary purpose for the \$1 billion bond financing we completed last month. The bond proceeds also will be used to settle the warrant when it is exercised and for other corporate purposes.

Cash on the balance sheet at September 30 was \$608 million, with net debt of \$1.9 billion. Net debt to trailing 12 month adjusted EBITDA is 2.6 times at quarter end. Total available liquidity is about \$1.2 billion.

Adjusted free cash flow for the first nine months was \$330 million, 14% ahead of last year. Year to date we have spent \$334 million to repurchase 3.5 million shares. In Q3 we spent \$101 million to repurchase 1.1 million shares at an average repurchase cost of about \$96 per share. At recent market prices we would expect to complete our current repurchase authorization before February.

Also during Q3 we recognized (technical difficulty) retiree benefits. Most of the gain relates to current employees or retirees of current businesses and is included in adjusted EBIT. Net of another item in the Q3 P&L, the benefit to adjusted EBIT was about \$11 million or \$0.09.

A couple of quick points on our outlook, and then I will turn to call back to Fred. We are narrowing our adjusted EBIT outlook to \$625 million to \$630 million. This reflects our good Q3 results and good business performance, offset by the negative effects of a stronger dollar and lower demand in Europe. Our outlook is based on a euro/US dollar exchange rate of 1.27. The stronger dollar is a substantial headwind to our Q4 results, reducing sales by about 3% and earnings by \$5 million to \$8 million.

With strong year-to-date performance, we've increased our adjusted free cash flow outlook to \$430 million or more. At yesterday's closing price, this equates to a 6.3% free cash flow yield.

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

Thanks, Hudson. I wanted to wrap up the call and just express again how I view how we finished the third quarter. Do I wish the global macroeconomic conditions were better? Yes. But when I look at what we successfully needed to complete this year, we are well on track or ahead of that.



If you remember, going into the beginning of the year, we needed to restore our position in our FCC catalysts business. We completed that with the new product introductions and the market adoption.

We needed to integrate our UNIPOL acquisition. That has been flawless; and, actually, we are ahead of plan.

If you think about our hydroprocessing catalysts business, we were way behind the curve with some of our first-quarter and second-quarter issues. We have fixed those issues. You see good performance in the third quarter, and you will see better performance in the fourth.

We needed to deliver on our productivity initiatives. Those are behind us and functioning very well for us across the business. We needed to capture the pricing in our construction chemicals business, both in North America and Latin America, and we successfully completed that.

And finally, we had a back-end-weighted plan, and we needed to deliver the strong second-half results. You know, the year is not over, but we've accomplished a lot. And we are better positioned today than we were at the beginning of the year. With that, we'll open it up for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Mike Sison, KeyBanc.

Mike Sison - KeyBanc Capital Markets - Analyst

Nice quarter there. In terms of the fourth quarter, given some of the headwinds that maybe are perceived for whatever, which you -- clearly, it shouldn't be an issue. But Europe is kind of weakening. How do you see the growth in catalysts in fourth quarter, roughly?

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

It would probably be good to just replay our third quarter for a minute. I mean, when we went into the third quarter -- our third quarter -- we were expecting very heavy turnarounds from our customer base. And we got those turnarounds, the heaviest of the year.

However, the customers that did not have turnarounds ran harder, which was a very good sign for us. As we go in the fourth quarter, we see it similar to the third quarter. There will be turnarounds -- not at the same level. But everything we see in the order books are strong for us on the catalysts side.

Mike Sison - KeyBanc Capital Markets - Analyst

Great. And then when you think about FCC catalysts heading into 2015, you know, it does seem that some big projects are coming on for folks. You've done a good job in the last couple of years giving us a feel for where the industry is at and maybe the potential for pricing. Any thoughts as we head into 2015 in terms of where we are, in terms of operating rates for the industry and potential for pricing?

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

Yes. You know, our back half or the second half of the year for FCC catalysts -- we'll grow about 8%. We're going to have some tailwind behind us, as you said, because some of the projects are coming on, some that have been delayed and so on.

On the pricing side of it, we'll evaluate it. It's more product-specific more than across the board. And I know our pipeline is good, based on some of the new technology we have, especially in the polypropylene side. So I'm encouraged on the specialty catalysts as we enter 2015 and where we are exiting it.

Mike Sison - KeyBanc Capital Markets - Analyst



Okay. Great. And last question: Hudson, you talked about -- Hudson talked about a lot of liquidity availability there. Stock buyback's completing up. Maybe give us an update on some of your priorities for cash? Anything in the acquisition front; what are your plans are if there aren't good acquisitions, and we start to move into 2015?

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

Yes. Let me address the acquisition side, and then I'll turn it over to Hudson. We're seeing more deals, and we are actually seeing some of the pricing start to moderate. You know, as I said in other calls, I thought pricing was very rich going through the year. I think we're seeing some moderation in that. And we are positioned to take advantage if those opportunities come up.

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

I don't have anything to add, really. I'll just remind everybody of the framework that we have in place. We do prioritize our internal investments. We have terrific growth investments over the next few years.

Fred made a comment on bolt-ons. We don't always -- we're not always able to predict the amount or timing of those. And when we have excess cash, we'll want to return a significant portion of that to shareholders.

Mike Sison - KeyBanc Capital Markets - Analyst

Great. Thank you.

Operator

John McNulty, Credit Suisse.

David Joseph - W. R. Grace & Co. - Finance Manager, IR

Tony, why don't we go to our next question, and then we can come back to John?

Operator

Brian Maguire, GSK (sic - Goldman Sachs).

Brian Maguire - Goldman Sachs - Analyst

I appreciate all the comments on the impact of lower oil. Just thinking it through, do you see your customers shift their feed slate to lighter crudes as the price of Brent or WTI comes down? Or do you just see the heavy or sour kind of crudes respond to that by going lower?

I noticed, also, you mentioned the last couple of quarters in Europe they have been sort of disadvantaged a bit, but with the strength of the dollar, weakness in the euro, I'm just wondering if there is any benefit from lower Brent to maybe your European customers?

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

Let me start with the last part of the question. Yes, we are seeing some benefit to our European customers. They ran heavy and hard in the third quarter -- basically because of that advantage they are having. Across the board in the US, we are seeing that they are either running very heavy, or they are running very light. This middle crude -- this West African seems to be going more to Asia on that side.



So we're following it very closely, working with our customers, trying to give them the most flexibility we can on that side of it. But as we said, Brian, we think as long as demand holds up for both plastic side as well as transportation, we feel we are in a good position.

Brian Maguire - Goldman Sachs - Analyst

Okay. And Hudson, I appreciate quantifying some of the FX hit. I think you said \$5 million to \$8 million hit in the fourth quarter from the strength in the dollar. Can you just remind me -- the sensitivity on a \$0.01 move in the euro, just so we can kind of keep track of it as that bounces around versus the 1.28 you guided for? And then if you were to look out to 2015, what kind of incremental impact might you expect in 2015 if it stays at \$1.27?

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

It's \$0.01 -- for each \$0.01 change in the euro/US dollar exchange rate, that's about \$2 million per year annualized for us. And the euro is two-thirds or three-quarters of our total currency exposure.

So what we're saying now is more about stronger dollar than weak euro. So the euro is the single biggest single exposure, but it's not the only exposure. And in terms of the impact on 2015, frankly, the impact that we've quantified from Q4 is a pretty good proxy of what you would expect heading into next year on an annualized basis, if currencies stay where they are today.

Brian Maguire - Goldman Sachs - Analyst

Great. And just one last one, if I could sneak it in. Is there any kind of cost reduction efforts or other things you can do to kind of mitigate some of that FX impact? Or anything you guys are contemplating at this point?

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

Yes. We are looking at it across the board. In Europe in general some of our short-cycle businesses in the engineered materials -- you know, we did see a slowdown in the third quarter, and we are taking some cost actions on that side of it. We are also looking at our supply chain.

Are there ways to take advantage of the dislocation and move costs around relative to what we're buying on that side, as well? So, no, these programs are active and will continue to accelerate. We won't just take it for what it is. We'll work them very hard, as we always do.

Brian Maguire - Goldman Sachs - Analyst

Great. Thanks very much.

Operator

(Operator Instructions) John McNulty, Credit Suisse.

John McNulty - Credit Suisse - Analyst

So a question with regard to the catalysts business: I was kind of expecting in terms of pricing in the third quarter -- I thought you would annualize some of the issues from the prior year, and yet we still saw pricing down a couple percent. So I guess I was curious what's driving that -- whether it's some mix-related issues, or if there's anything else you can maybe shed some light on for us?

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

John, it's two specific situations as we work to move that business forward. It's not something that we think is fundamental to the operations.



John McNulty - Credit Suisse - Analyst

What are those two issues?

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

I'm not going to elaborate.

John McNulty - Credit Suisse - Analyst

Okay. Fair enough. That's it for my questions. Thanks very much.

Operator

Laurence Alexander, Jefferies.

Laurence Alexander - Jefferies & Company - Analyst

So, first, could you give some incremental -- some sequential color on the trends in material technologies? Any end-markets that you are seeing acceleration or deceleration?

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

Yes, Laurence, it's Fred. In our packaging business, the Darex business, we've seen that business basically flat, really tied to a lot of the consumer beverage side of it as well as some canned packaging and so on. On the flip side, our discovery science, our fine chemicals -- that is experiencing double-digit growth on that piece of it. And we're seeing strong growth in our silica business related to coatings, coatings applications that go into either white goods to architectural coatings. So we feel good about that.

Laurence Alexander - Jefferies & Company - Analyst

And in catalysts it's been a while since we've had a noticeable spike in the raw materials. So as you look at the key ones that have caused spikes in the past -- you know, the zeolites, or rare earths, or molybdenum, what's your comfort zone on the supply/demand balances in those over the next, say, four to six quarters?

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

Yes. We are very comfortable with that side of it. Both from rare earth to -- all the way through the hydroprocessing catalysts, the metals, as well. We don't see any dislocations coming on that side of it.

Laurence Alexander - Jefferies & Company - Analyst

Okay. Thank you.

Operator

(Operator Instructions) Mike Ritzenthaler, Piper Jaffray.

Mike Ritzenthaler - Piper Jaffray & Co. - Analyst



Can you remind us on where we are for Grace's share of ART net income for the year, for year to date versus 2013, and what the full-year expectations are for ART versus last year?

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

I think we are \$11 million year to date, thereabouts, Mike. It was \$6 million in the third quarter. And I'm sorry, I don't have an exact year-to-date number in my mind. But it's pretty close to that. Full year we expect to be about flat from last year.

Mike Ritzenthaler - Piper Jaffray & Co. - Analyst

Flat to last year -- okay. And then what's the year-to-date contribution so far from UNIPOL? Is that something that you can break out separately?

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

We said when we bought it that we would expect about \$30 million EBIT contribution this year. And the business is on track. We expect it to achieve that on a full-year basis. And in the first two quarters, we had the integration costs and all of that. That's all behind us now, and Q3 was a pretty clean read on what the UNIPOL contribution would be. I'm not going to be exactly specific, Mike, with what it was in Q3.

Mike Ritzenthaler - Piper Jaffray & Co. - Analyst

No, that's fine.

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

We're exactly where we wanted to be in terms of our acquisition plan. And we did say that \$30 million number for the full year.

Mike Ritzenthaler - Piper Jaffray & Co. - Analyst

Okay. That's helpful. And just one last thing -- on interest rates, given when the debt deal closed, can you provide us with just kind of some goalposts around what the interest rate expense could be in Q4, maybe starting in 2015?

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

Let me follow up on that, Mike. We know the numbers; I don't have them off the top of my head. Everything is fixed at this point, so it's just a matter of -- we'll send that out in an email later today to everybody.

Mike Ritzenthaler - Piper Jaffray & Co. - Analyst

All right. Super. Thank you, guys.

Operator

Jim Barrett, CL King.

Jim Barrett - CL King & Associates - Analyst



Fred, could you compare your current growth -- your outlook for growth in your emerging markets versus your mature markets, with some added color on what's happening in Latin America with and without the Venezuela piece?

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

Yes, we are clearly getting good growth in North America. The growth in Europe is -- across the corporation is not at, obviously, at that same pace. Latin America still remains challenging. I mean, in our construction chemicals side, we are experiencing growth -- not at the same rate we would like, but still experienced some growth. So, net-net the emerging markets have not grown as fast as last year, but we're being offset and balanced by the North American growth.

Jim Barrett - CL King & Associates - Analyst

Okay. So are emerging markets growing -- is it mid-single, upper-single-digit type of growth rate? Can you give us some general --?

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

Yes, that would -- I mean, again, you've got this whole -- you have currency fluctuations, especially with the strong dollar; but net of the currency fluctuations, it's about 5%.

Jim Barrett - CL King & Associates - Analyst

I see. And then my second question is, given that the demand or the decline in demand for your residential products related to the SBM category in North America appears to be more related to the category as opposed to what's occurring at Grace, can you comment on how you are repositioning those products for growth, given where the end markets seem to be?

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

Yes. We called it out, because we believe it's an opportunity for us. That segment for us -- it's a good profitable segment, represents an opportunity. We need to make sure we have the right products in the channel with those distributors in the right geographic areas. So we're looking and repositioning with our channel partners on that to make sure -- you know, if it's Midwest, we need this type of product; versus New England, this type of product; and working with those distribution partners on that. So again, called out because we think it's an opportunity for us to do better.

Jim Barrett - CL King & Associates - Analyst

Okay. Well, thank you very much.

Operator

Chris Kapsch, Topeka Capital Markets.

Chris Kapsch - Topeka Capital Markets - Analyst

Yes. Good morning. My questions are focused on the catalysts segment. And I'm looking at the positive variance gross margin year over year of 330 basis points. I know you mentioned that the biggest piece of that was the addition of UNIPOL; that makes sense.

I'm just wondering -- if you were to exclude UNIPOL, what would that gross margin comp look like? The reason I ask -- I'm just wondering, as you are gaining back your position in the marketplace with these advanced products, just wondering if those are contributing favorably to pricing and mix and, therefore, margins?

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



Chris, it's Hudson. It's probably half of the improvement is related to UNIPOL, and balance is related to better operating leverage with our FCC catalyst business, as we have more volume in that business on a year-over-year basis.

And, also, these new products that we've introduced are selling at better gross margins to us. And finally, frankly, there's some productivity that we're doing in the catalyst business. That's not fully in the P&L yet, but it will flow through more as we get into next year.

Chris Kapsch - Topeka Capital Markets - Analyst

Okay. And then another follow-up: I appreciate your comments about the correlation of FCC catalyst demand. Clearly there was some perhaps misguided acute selling pressure on your stock, associating Grace as just purely some energy play during the quarter.

And so I understand the correlation to transportation fuels and the refinery utilization rates. You made an interesting comment that you correlate inversely to feedstock quality. I think that's sort of another way of saying -- like, covering Engelhard in the past and Grace years ago, the focus was always on crack spreads. And I think that's another way of saying inversely correlated to feedstock quality.

So the question is: as the global feedstock slate changes, and given the further introduction of the shale oil, I'm just wondering how you feel now, a couple of years into this fracking phenomenon, about the continued migration of the crude slate? Is it something that's favorable to the crack spreads that will -- should drive incremental demand for FCC volumes, or is this something that ultimately could be a headwind for FCC catalyst demand?

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

We see it as a positive. The light frack crude has its own challenges with it, and those challenges are metal contaminations and so on. It's requiring the catalysts to be able to handle that side of it.

And then if you look where these new big units, refineries, are being built, they are using heavy -- you know, the new refineries in the Middle East -- they are using heavy crude slate. So those two dynamics play well. And the balance of it in North America -- these refineries only can take so much of the light side of it. So you are seeing a combination of light, which we need to continue to work with our customers on mitigating some of the properties, and then a heavier slate across the globe.

Chris Kapsch - Topeka Capital Markets - Analyst

So the international slate is becoming -- it's less quality, so that's favorable; and then the light, tight slate is not an adverse trend, given the complexity of some of these contaminants?

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

That's a good way to summarize it. Thanks. I probably should have -- that would have been a simpler explanation.

Chris Kapsch - Topeka Capital Markets - Analyst

I appreciate it.

Operator

Tyler Frank, Robert W. Baird.

Tyler Frank - Robert W. Baird & Company, Inc. - Analyst



I was wondering if you can talk a little bit about the recent price increase that you put through for silica products and how that's going? Does the fluctuation in FX rates -- can you give a little bit of color on how that may impact your decision to put through price increases maybe over the next year or so, if the dollar remains strong?

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

Yes. We initiated that price increase because our silica business was almost in an oversold position across the globe, and the applications that we sell into have been strong. Now, I will tell you, it's early; we put it out in October. It's early in that cycle.

I think in the end of the day, it will be more rifle shot and selective. Where we are seeing strength in certain applications or certain geographies, we will be able to achieve that. In others, maybe where the growth is not as robust because of some of the macroeconomic trends that have -- recently we have been seeing, we may wait a quarter or two on that side.

So it will be a little more selective as we go. But it's clear: the silica products (technical difficulty) that demand is there. There has been very good receptivity to some of the new applications we've put out.

Tyler Frank - Robert W. Baird & Company, Inc. - Analyst

Great. And then just to touch on the residential SBM market: so you are repositioning that for better growth and hope to have those initiatives complete by the end of this year. Can you just go in a little bit more detail on what you are doing there?

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

Yes. Remember, our residential building materials product is primarily underlayment and some specialty products, primarily for reroofing and so on. We need to make sure that we've got the right products in the right channel with the right distributors around the right geography.

I mean, you are trying to match all of that sides of it as -- trying to anticipate the weather, and so on, and anticipate where we're going. So I feel good about the work that's being done with our teams, as we highlighted. Listen, we were down in the third quarter in that business year over year, and that's a big -- not big; that's an opportunity for us to get that back, and we will.

Tyler Frank - Robert W. Baird & Company, Inc. - Analyst

Thanks, guys.

Operator

John Roberts, UBS Global Asset Management.

John Roberts - UBS - Analyst

Thanks for taking my call. Some of the slowdown in oil demand seems centered on China. But since China makes their own FCC catalysts, do we see production of Chinese FCC catalysts sort of absorb Chinese oil demand fluctuations? Or does it basically come out of the rest of the world, where you serve the market? Do the oil imports, oil and gasoline imports into China fluctuate; and, therefore, if they slow down, we see your -- these big, global catalysts markets slow down, not just the Chinese?

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

I think your observation is right. On the FCC catalysts side, they are 90% self-supplied. So if crude demand in China slowed, that would come out of Chinese FCC catalysts supply more than us or our global competitors.



John Roberts - UBS - Analyst

Really? They wouldn't hold their production, and their imports of crude and refined products would drop, and therefore it would come out of the Western world?

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

Maybe I misunderstood your question, John.

John Roberts - UBS - Analyst

Do they hold their FCC production sort of irrespective of their demand for crude products and oil?

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

No. I think it varies with their local requirements.

John Roberts - UBS - Analyst

Okay. Thank you.

Operator

Chris Shaw, Monness, Crespi.

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

You spoke briefly, I think, a little bit on margins -- on the margin opportunities on catalysts. I was just curious, in the other two segments, construction and materials, what's the near-term -- and maybe looking into 2015, are there specific margin opportunities in either of those that we should be looking for, either on a cost productivity or a pricing side?

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

Yes. On our construction side of it, we have been able to expand our EBIT margin. For construction the more relevant factor is the EBIT margin versus our gross margin, because we are trying to get that leverage through it. Those opportunities are in volume leverage and will continue.

So we see, as market dynamics continue to get better, that there will be those opportunities to leverage that margin up on the construction side. In materials we are focused on making sure where we see, if there is -- geographies, where there is a slowdown, to make sure we are reducing our costs in those operations, proactively, getting out in front of that side of it; as well as looking across the whole materials segment to make sure that the productivity investments we are spending, like the big investment we did here in our Curtis Bay facility, pays off.

So on the materials segment, it's really -- how do we protect these margins if the slowdown in the global economics get worse? Construction -- the opportunity is to continue to expand those margins.

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

And if I could follow up with a question about commercial construction demand: it looked pretty good in the quarter. Do you view that as sort of an ongoing -- I was wondering if there was any makeup during the quarter for the sort of -- I know the second quarter was impacted by weather. So was that sort of demand level we saw from commercial construction in 3Q sort of what's really true to the market? Or was that some makeup at all?



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

Yes, there is probably a little bit of a makeup in it. But still, the quote books look good; the architectural index; the jobs we are seeing. So out of that 10% -- this is my estimate -- 80% is probably its true market. 20% is just to catch up on that side of it. So we are encouraged by what we saw.

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

Great. Thanks.

Operator

Ladies and gentlemen, thank you for your participation in the question-and-answer session. We will now proceed with closing and/or any additional remarks.

David Joseph - W. R. Grace & Co. - Finance Manager, IR

Thanks, Tony. I'd like to thank everyone for joining the call today. If there are any further questions, please contact me at 410-531-8209. Thanks again. Bye.

Operator

Ladies and gentlemen, thank you for your participation. You may now disconnect. And everyone, have a great day.

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