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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2018 W.R. Grace and Company Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Jeremy Rohen, Vice President of Investor Relations and Corporate Development. Sir, you may begin.

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

Thank you, Jimmy. Hello, everyone, and thank you for joining us today for Grace's fourth quarter and full year 2018 earnings call. With me this morning are Hudson La Force, Grace's President and Chief Executive Officer; and Bill Dockman, Vice President and Interim 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 businesses, 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 2018 business performance, touch on our 2019 outlook and discuss our progress around our key strategic initiatives. I will then cover our financial results for the quarter and provide additional color on our full year 2019 outlook.

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 and CEO***

Thank you, Jeremy. Good morning. I hope everyone is well. I have a cough this morning so please bear with me if I cough. I am pleased with our strong performance in 2018. We beat our targets and delivered double-digit sales and earnings growth, strengthened customer relationships in every business and region and significantly improved our ability to consistently deliver profitable growth.

Sales grew 13% for both the fourth quarter and the year. Adjusted EBIT grew 3% for the quarter and 10% for the year, and adjusted EPS grew 22% for the year, including 13% growth from operations and 9% from lower ETR.

We invested over $600 million in faster growth through R&D, capital spending and the acquisition, and returned $145 million to shareholders during the year. Our strong cash flow allowed us to make all of those investments and reduce our net leverage to 3.2 turns. As we indicated at the time of the acquisition, we expect to be back below 3 turns by the end of this year.

With the Grace Value Model as our framework, we are investing in innovation, value selling and manufacturing excellence to ensure we are delivering value for our customers and shareholders. These investments are producing results that I see in our improved growth rates and earnings.

Please turn to Page 5, and I'll discuss our 2019 outlook.

We expect 2019 to be another solid growth year with strong demand for our high-value technologies, improved gross margins, double-digit adjusted EPS growth and strong cash flow. Specifically, we expect 6% to 7% sales growth and 7% to 9% adjusted EBIT growth in line with our 5-year financial framework. This outlook includes solid demand for our Catalyst and Materials Technologies. While we are clearly planning for growth, we are maintaining a balanced footing in the event demand slows in the future. We watch inventory, headcount and cost levels very carefully to ensure we don't get ahead of our growth. Staying agile in response to changing market conditions is important to us. For example, during Q4, when market concerns increased about the pace of 2019 global growth, we proactively reduced production rates as the derisking measure, even though we didn't see any significant demand weakness in our performance data. We took advantage of this opportunity to run product trials in some of our specialty catalyst plants. These actions temporarily reduced margins and earnings growth but were clearly the right thing to do to ensure we remain well positioned for growth in 2019.

I want to emphasize that we took these actions to reduce risk, not in response to any change in demand.

Turning to Page 6, it has been almost a year since our Investor Day when we presented our growth strategy and introduced the Grace Value Model to investors. I want to give you an update on the progress we made in 2018 against our key strategic initiatives. First, we've successfully accelerated our investments in high-return growth projects. These investments are primarily in Specialty Catalysts and Materials Technologies where we have the strongest growth drivers. Importantly, these capacity and productivity investments are timed and sized to meet identified customer demand. Over 90% of our current growth capital is linked to specific customer investments, contracts or licenses. Second, we continue to see clear benefits from the Grace Manufacturing System, which is improving our manufacturing operations through increased production, reliability and efficiency.

Our GMS implementation is currently focused on 5 plants with the greatest opportunity. The most significant investments in GMS have already been made, and we are confident we will see a payback in less than 2 years. GMS delivered a 50 basis point benefit to gross margins in 2018. For example, at one plant, we did a GMS implementation focused on improved reliability. In less than 1 year, reliability increased by over 6 percentage points. The resulting higher volumes and lower costs added millions to 2018 earnings.

Shifting gears, the single-site polyolefin catalyst acquisition is delivering on our key business objectives of strengthening our technology position, enhancing our technical and manufacturing capabilities and broadening our relationships with our customers. The business is well integrated into Grace at this point and is on track for the sales, earnings and synergies we expected. Our scientists and business development teams are seeing some exciting opportunities as they work with our customers to leverage the combined technologies of Grace and the acquired business.

From a financial perspective, the acquisition contributed 7% growth to the Catalysts segment this year. Overall, I'm pleased with the progress we're making as a company. I'm excited about the strong commitment and engagement of our employees and the great work they're doing with our customers. I'm confident we have the levers we need to achieve the commitments in our 2016 to 2021 financial framework.

Please turn to Page 7 to discuss catalysts.

Catalysts Technologies has delivered another strong year with sales 15%. We saw a 5% higher catalysts sales volumes and continued strength in UNIPOL process licensing technology. Last year, we announced 4 new polypropylene process licenses, totaling over 1,500 KTA of new capacity. In January, we announced another 400 KTA license, and we are encouraged by the robust pipeline of future opportunities.

Q4 sales were up 18%, driven by 8% volume growth, 210 basis points improved pricing and an 8% contribution from the acquisition. Specialty Catalysts sales were up 11% organically plus $28 million from the acquisition in the quarter. Refining Technologies sales also were up about 11%, including strong volume and improved pricing. FCC catalyst pricing improved by more than 200 basis points last year, and we expect pricing to improve more than 200 basis points in 2019 as well.

We made significant progress in 2018, shifting our portfolio to those customers that value our high-technology products and problem-solving capabilities. We are working closely with these customers to help them optimize their margins in a dynamic world.

Our ART joint venture continues to experience solid demand for its hydroprocessing catalysts. We are working closely with our customers to help them meet market demand for increased diesel production as the IMO 2020 deadline approaches. ART's industry-leading technologies position the business well to capitalize on this clean fuels opportunity. As a reminder, growth in our catalyst business is driven by the global demand for plastics, petrochemical feedstocks and cleaner transportation fuels. Volatility in crude prices create opportunities for us as customers use our technologies to optimize their margins in a changing environment.

Let's turn to Materials Technologies on Page 8.

Our materials business delivered a solid year in 2018, with sales up 7% on higher volumes and improved pricing. In Q4, volumes and prices were up about 3% but fully offset, given the dollar strength against other currencies. MT delivered more than 200 basis points of improved pricing through value selling and a commitment to customer-driven innovation. MT demand remained solid globally, but we did see some slower growth in the China coatings end in market in Q4. This is a relatively small end market for us at about 5% of segment sales.

One of the strengths of the MT model is our ability to shift focus from one end market to another as market conditions change. We've already shifted more than 10% of our sales into faster growing, more profitable end markets.

We're seeing strong demand for our high-value specialty silica technologies and the benefits of investments in customer-driven innovation. As an example, our team recently developed a new silica technology to help one of our customers achieve a key sustainability commitment to reduce water usage in their manufacturing process. This customer-driven innovation created a compelling value proposition for our customer and an attractive growth and margin opportunity for us. As a reminder, growth in our materials business is driven by growing global middle-class incomes, stricter environmental standards and increased focus on health and wellness in addition to general economic growth.

I'll now turn the call to Jeremy, who will discuss our financial results and outlook in more detail.

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

Thanks, Hudson. Let me begin on Slide 10 with our fourth quarter results.

Q4 sales were $520 million, up 13%. Sales were up more than 8% organically on higher sales volumes and improved pricing in both segments. Adjusted gross margin for the quarter was 38.3%, down 250 basis points, largely driven by the impact of our proactive decision to reduce production rates in Q4. As Hudson said, this was done to reduce risk, not in response to any change in customer demand.

Adjusted EBIT was up 3% on strong organic growth. Adjusted EBIT margin was 22.8%, down 220 basis points on lower gross margin. Adjusted EPS was $1.14 per share, up 16%, including the benefit from a lower effective tax rate. For the year, our adjusted free cash flow was $235 million, including higher capital spending as part of our multiyear investment plan to accelerate growth. Adjusted EBIT ROIC was 20.9%, down year-over-year as the result of our acquisition in Q2, but up 30 basis points from last quarter.

Now let's turn to Slide 11 to cover capital allocation.

In 2018, we continued to execute our disciplined capital allocation strategy. We made significant investments in our business while continuing to return cash to shareholders. First, we invested $216 million of capital in our plants, with more than 60% of the investment dollars directed towards high-return strategic investments. In Q2, we acquired the leading single-site catalysts business for $418 million to strengthen our technology and manufacturing positions in this high-growth segment of the polyethylene industry. We're on track to deliver our synergy commitments, which will result in a post-synergy purchase price multiple more than 3 turns below the announced multiple. For the year, we returned $145 million of cash to our shareholders, including $65 million in dividends and $80 million in share buybacks. We ended 2018 at 3.2x net leverage and expect to be back in our target range of 2 to 3x by the end of 2019.

Moving to Slide 12.

Let's take a more detailed look at our 2019 outlook. We remain upbeat about the fundamentals of our businesses and underlying markets. We are positioned to deliver another solid year of growth, expand our margins and execute our capital investments. For the full year, we expect revenue growth of 6% to 7%, including organic growth of 5% to 6% with solid demand and improved pricing in both catalysts and Materials.

Looking at our business segments, the organic growth rates we've provided at our Investor Day continue to reflect our views of the businesses today. We expect high single-digit growth from Specialty Catalysts, mid-single-digit growth from Materials and low single-digit growth in Refining Technologies, benefiting from a continued shift towards faster-growing crude-to-chemicals applications. We expect 2019 adjusted EBIT in the range of $490 million to $500 million, up 7% to 9%, and adjusted EPS in the range of $4.53 to $4.63 per share, which is up 10% to 12%. Earnings growth and margin expansion will be driven by our solid top line growth and benefits from our commercial and operating excellence initiatives. We do expect some continued headwinds from inflation this year and moderate headwind from FX in the first half of 2019. Our adjusted free cash flow is expected to be between $235 million and $250 million.

Finally, looking at Q1, we expect year-over-year adjusted EPS growth of 7% to 9%, driven by strong business performance, including solid organic growth. This is slightly below our full year growth rate of 10% to 12% because of approximately $10 million to $12 million of headwinds from inflation and FX in the first quarter.

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

QUESTIONS AND ANSWERS

Operator

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

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

John, we can't hear you.

John Patrick McNulty ***Crédit Suisse AG, Research Division - Former MD & Co-Director of Research in the United States Equities Division***

Can you hear me now? Sorry about that.

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

Yes, you're loud and clear now, John.

John Patrick McNulty ***Crédit Suisse AG, Research Division - Former MD & Co-Director of Research in the United States Equities Division***

All right. Apologies. So with regard to the catalyst business, we look and -- when it comes to your guide, it looks like you're looking for low single digits from the FCC side. And it sounds like a lot of that's coming from the pricing side. I guess -- I believe, you're at the point now where you're somewhat capacity-constrained. Can you give us an update on the new capacity that you were looking to ramp up in the Middle East and how that might unlock future growth going forward?

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

Sure, John. Your analysis is right. As we look into next year, we are expecting low-single-digit growth from [FCC] (added by company after the call) catalysts. We do see low-single-digit volume growth plus the benefit of improved pricing. The demand driver there is really the increasing demand for petrochemical feedstocks as our customers run more and more for propylene. The -- but to your -- the longer term part of your question, we do -- we've done the engineering for that project, we are waiting to start that project to make sure that it's timed with demand in the region. We don't want to do anything that upsets the balance of supply and demand globally. And when we see that demand present, we'll proceed with construction.

John Patrick McNulty ***Crédit Suisse AG, Research Division - Former MD & Co-Director of Research in the United States Equities Division***

Great. And then maybe just a follow-up. With regard to your Specialty Catalysts volume growth where you're looking for, it looks like, high single digits, which -- or at least high single-digit sales growth. How much of that is dependent on the macro versus either new facilities coming up and/or things that you've locked up, whether it's tied to some of the licensing business, et cetera? How should we think about the sensitivity of that business as we look through 2019, given the macro headwinds or tailwinds?

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

It's a combination of those things, John, as you might imagine. Over time, the macro environment is going to drive the demand for plastics. And plastics has grown at a premium to global GDP for a long, long time, and we expect that trend to continue. In the shorter term, it is affected by startup of new investments, for example, or a new product win that we might have with an individual customer. But I'd tell you that an individual plant starting up or an individual win with a customer in a quarter, maybe that makes the growth rate a little higher, but over the course of a year, and certainly over the course of multiple years, it's really driven by the long-term demand for plastics.

Operator

Our next question comes from Christopher Parkinson with Crédit Suisse.

Kieran Christopher De Brun ***Crédit Suisse AG, Research Division - Research Associate***

This is Kieran on for Chris. I was wondering if you can talk a little bit more about your forward outlook for margins and give any color on how you expect gross margins to evolve throughout the course of the year, especially considering the actions that you took throughout this quarter?

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

We do expect margins to expand for 2018 into 2019. In 2018, gross margins expanded at about 60 basis points, and that's a typical margin expansion for us over time. I don't see anything that's going to change that general rate as we look into the future.

Kieran Christopher De Brun ***Crédit Suisse AG, Research Division - Research Associate***

Great. And I guess, in -- looking at Materials Tech, it seems like you're still seeing good pricing, but volumes seem to have slowed a bit this quarter. Pharma consumers still saw a little bit of growth, but chemicals and coatings seem to be stagnated. Can you discuss your outlook for '19 maybe by region? And then, maybe any leverage you can pull to accelerate that demand or win market share going forward?

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

Sure. So what we saw at the end of last year in Q4, coatings growth wasn't as strong as it had been earlier in the year. We did see some slowdown in China, as we commented earlier. On the chemical process side, we had a very strong chemical process quarter, Q4 of '17. And so we had a tough compare there. But as I look generally at MT's growth momentum, I feel very good about MT's growth momentum. And as we look into next year, Jeremy's guide, and I think it's right there's mid-single-digits growth in that business. And we'll see growth in coatings. We'll see growth in consumer pharma, and we'll see growth in chemical process.

Operator

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

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

Hudson, did the volatility in the crude oil markets have any appreciable impact, either positively or negatively on your businesses?

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

Kevin, there's always volatility. So it's hard to say whether Q4 volatility had any different impact than Q3, Q2 or Q1. Volatility really -- it creates opportunity for us at the end of the day. And it's not always an opportunity that we capture in the current quarter. But when our customers see changes in their operating environment, whether it's crude prices or something else, new regulations, whatever it may be, it leads them to think about how they reoptimize their refinery operations. And the catalyst is a very important lever to them in that problem-solving as you know. And so the way I think about it is, volatility really creates opportunity for us with our customers. But as I said, it doesn't always pay off in the current quarter.

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

And as a follow-up, a fair amount has been written in the popular press about U.S. oil production light sweet, crude, in particular, and that's had a pronounced impact on a light-heavy spreads. As I look at your financials, it would seem that ART posted a very strong equity earnings quarter. And so can you talk about, I guess, trends at that joint venture in the context of what's going on in the energy markets and also what's going on ahead of IOM -- IMO 2020?

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

Sure. So if I think broadly about the ART joint venture, the growth driver for the business is really 2 things: its customers processing heavier feeds and customers trying to produce a cleaner fuel, sort of low-sulfur fuel. Those are the 2 fundamental drivers. And while in North America, the crude slate has been getting lighter with the shale production, as you noted. On a global basis, feed has been trending towards heavier, harder-to-process crudes. And that's driven our customers to invest in hydroprocessing units and ultimately creating demand for our hydroprocessing catalysts. Clean fuels regulations have been a growth driver in this business for many, many years. And IMO 2020 is really just the latest chapter in a longer book about clean fuels' regulations. And a year -- I guess, it's actually been 2 years now when those rigs were firmed up for a 2020 effective date. We saw customers that had hydroprocessing investments already planned. In some cases, they were timed to start up with IMO 2020. In other cases, they were not originally timed there, but customers were able to do some acceleration. Some customers that had been thinking about it firmed up plans to proceed. And so we see that regulation really, what's the right way to say, bolstering our customers investment decisions in hydroprocessing capability, which in turn bolsters our opportunity. And this business is growing 6% to 7% a year for a while. We think that growth rate continues this year, but beyond 2020 as well the customers continue to make these investments.

Operator

Our next question is from John Roberts with UBS.

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

You said you ran more trials in the quarter in anticipation of weakness in customers. That's not normally something that you call out. And I thought the weakness at the customers was pretty late in the quarter. So maybe you could elaborate a little bit more on, was that just right at the very end of the quarter that you were doing some of that activity?

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

I want to be very clear. We have seen no weakness in demand from customers. And I want to -- I can't be too clear on this. And John, I'm not just speaking to you, but everybody. We took a derisking action in Q4 because of the concern -- heightened concern about growth in 2019. That was a market concern. We wanted to be proactive and derisk, but we've seen no slowdown in demand from our customers. Our Specialty Catalysts plans ran pretty hard this year, and we didn't have as much trial time in those units as we would like to have. And when we made the decision to slow down some of the plants, it was a great opportunity to accelerate some of the work that we've been doing on products. And that's what we're trying to communicate. This was a derisking action, but not, in any way, in response to lower customer demand.

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

Can you tell us a little bit about some of the new products that you're trialing because, obviously, you were doing more activity than normal on new products?

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

Yes, I mean, this is in both polypropylene and polyethylene end-use applications. These were customer-driven trials where we're doing joint development with our customers, ultimately design to help them produce the resin characteristics that they are seeking to produce for their customers. I'm not going to be more specific than that, John. It's too early, and we're still working very closely with our customers on these development projects.

Operator

Our next question comes from Robert Koort with Goldman Sachs.

Christopher Mark Evans ***Goldman Sachs Group Inc., Research Division - Associate***

This is Chris Evans on for Bob. I just wanted to maybe go on that point a little bit more. I mean, you referenced the possibility for softening market conditions that didn't end up materializing. But maybe could you just contextualize for your business, you catalyst business as a whole, how much volatility is even possible in catalysts sales, given the strong visibility your customers likely provide for startups or turnarounds, given you probably have a pretty good read on the first of half at the very least. Just could you give any context to what's going on there? And then just on the fourth quarter real quick, your refining catalyst line stepped up pretty massively, up 11%, and for the year, you guided a low single digits in '19 and then I don't think at one point in the -- in '18 did you reach those low levels. So just wondering if you can kind of describe the cadence and what's going on there too?

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

Sure. So on your first question, Chris, I appreciate the question. The demand for catalysts is actually pretty resilient. And if we go back to the '08, '09 time period, and I don't think anybody is predicting that, that period repeat itself, but it's a data point that we have. We saw a decline in catalysts demand that was low single digits, literally a few percentage points even in that environment. And so we believe that demand for catalysts is pretty resilient in any downturn, mostly because the demand for transportation fuels is pretty resilient, the demand for plastics is pretty resilient. And remember, all of these are global businesses, so our exposure to any one market is relatively small. The other thing that's important to note is catalysts inventories are never that significant. In RT or in -- sorry, in Refining Technologies or in Specialty Catalysts, there is not a lot of inventory that we have, and there is not a lot of inventory that our customers carry. So we don't see that inventory bullwhip effect when demand changes. On the second part of your question about RT growth rates, we did have a strong quarter in Q4. We had a good growth year in 2018. We do believe that we'll have a low single-digit growth rate as we head into the future. That's our multiyear view on growth in this business, and we think it aligns well with the underlying drivers around transportation fuel and propylene production.

Christopher Mark Evans ***Goldman Sachs Group Inc., Research Division - Associate***

And then in the catalysts segment, you reported 2.1% pricing and noted FCC was greater than 200 bps, but FCC is not 100% of this segment. So just curious, are you seeing pricing or mix support elsewhere in the portfolio to maintain that 2% plus pricing for this segment? And then just curious, in your '19 guidance, does FCC and MT pricing more than offset the inflation you guys are expecting?

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

In your question about catalysts pricing, FC does get some pricing. I will tell you that the RT pricing was greater than the FC pricing. And then yes, we do expect pricing in 2019 to offset -- more than offset inflation.

Operator

Our next question comes from Mike Sison with KeyBanc.

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

In terms of the first quarter, a lot of chemical companies are struggling a little bit, and your outlook seems pretty good. So when you think about the 7% to 9% EPS growth, can you maybe talk about the underlying sales growth, EBIT growth? And is that $10 million headwinds, is that the largest for the year in terms of how big that is?

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

Mike, we're not going to give more specific color on Q1. But as Jeremy said in his prepared remarks, we do see good business performance in Q1, but we do have these headwinds, and the FX headwinds are really for the first half. The inflation headwinds are for the first half more than the second half. Q1 might be a little more than Q2, but you should think of it as a first half headwind, and we were just a little more specific on Q1.

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

Okay. And then, again, the fourth quarter, pretty solid relative to others and oil price you said, historically, doesn't really dictate demand to some degree, but you did see it fall quite a bit. Are there any benefits from that in terms -- or major negatives from the oil price? Did customers think about maxing propylene a little bit more? And then what are your thoughts here at current levels, does it affect the business at all going forward?

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

Well, so let me deal with the Q4 part first. I think John asked a similar question. In the short term, changes in crude prices create conversations between us and our customers. But those are conversations that usually take months to -- a handful of months to play out. Some of our customers are more nimble. But in general, as our customers see changing market conditions, it takes them some time to respond. Refineries are big complex operations, as you can imagine. And so they don't tend to respond to changes that they see as temporary or pure volatility. But when things are trending, they do want to respond to that, so that they continue to maximize their margins. Over time, a lower crude price should ultimately translate into lower transportation fuel costs and lower plastic feedstock costs. That supports demand for transportation fuels and supports demand for plastics. And -- but it's a balance. You don't want crude prices too low, customers won't invest. You don't want them too high, you run the risk of a demand destruction. But I think that's a very broad range, 40% to 100% or 30% to 100% or something like that, before you see significant long-term changes in behavior.

Operator

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

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

Hudson, just wanted to follow-up on the conversation around the derisking action that you took and just want to make sure I understand that was focused exclusively on the polymers and specialty businesses and did not relate at all to any manufacturing facilities on the refining tech side?

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

No, this was in catalysts where we -- the catalysts segment where we did this. Where we took advantage to do the product trials was in Specialty Catalysts.

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

Got it. And then so just to follow-up on -- I get the macro and obviously a global sort of destocking in the polymers supply chain. So maybe that contributed to the impetus for the derisk action. But there was a disconnect than with what you saw. If anything, it seems like your sales may be -- the demand was even stronger than expected. So I'm just wondering where do you think was the source of that disconnect? And is there still the potential that you see a belated slowdown from your customers henceforth?

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

I'm going to try one more time to be as clear as I can possibly be on this. We have seen no change in customer demand. What we did in the fourth quarter was not in response to any change in customer demand. What went through our mind was market participants were getting increasingly concerned about the pace of 2019 growth, and we said to ourselves, maybe there is something out there that we're not seeing in our demand data. Let's be prudent and derisk a little bit. As we stand here on February 7, we haven't seen any change in customer demand. But I'm glad we took the derisking decision. It was the right thing to do at the time, given the level of uncertainty that was starting to manifest in the market, but we did not and have not seen any change in customer demand.

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

And Hudson, the cost accounting hit associated with this action to the gross margins, when does that normalize? Does is it spill over into the first quarter?

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

No, that's a great question, Chris. This is Q4, it's done.

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

Okay. And then, if I could, just a follow-up on the FCC pricing outlook more than 200 bps. Is that a function mostly of a customer mix and upgrading to the higher-end technologies? Or is there also some like-for-like, year-over-year price increases tied to maybe customers that where you've seen the supply agreements rollover, the multiyear supply agreements rollover?

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

It's all of the above, Chris.

Operator

Our next question comes from Laurence Alexander with Jefferies.

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

This is Dan Rizzo on for Laurence. You mentioned shifting I think 10% of sales to faster-growing end markets. I was wondering if you could just elaborate on what you were shifting towards and from (inaudible)

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

Sure. It's a great question, I appreciate it. So when we look at our -- this is a Materials Technologies question for everybody. When we look at our Materials Technologies business, we look at it in a handful of subsegments. You see the 3 groups: the coatings, consumer pharma and chemical process. We look at it at another level of detail. And those end markets, different ones are growing at different growth rates. Our best growth rates right now are in consumer pharma subsegments, and within chemical process, there's some environmental end-use applications for our silica technologies where we're seeing a better-than-segment average growth rates and opportunities in the future. In coatings, it's more niche than that. There are very specific coatings end-use applications where we've brought a specific technology to a specific niche, and we're investing more in that type of technology. But broadly speaking, it's consumer pharma and the environmental -- a couple of different environmental end-use applications within chemical process.

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

Okay. That's helpful. And then one of the questions, you mentioned also inflation headwinds that are going to be staying in Q1. Again, I was just wondering what specifically you're referring to? I don't think it's oil related, but where is the inflation coming from?

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

This is mostly organic materials, metals -- sorry, I said organic, inorganic materials, metals, energy. This is where we're seeing the inflation. 100 to 150 basis points is our estimate for the full year. A little heavier in the first half just on a year-over-year basis. We have almost no exposure to organic or crude-derived raw materials.

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

Would that be labor? I mean, would labor be a part of that as well? Labor completion?

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

Yes, I mean, labor is certainly in our cost base. We do see labor cost inflation, but nothing that's out of the ordinary or noteworthy.

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***

Just maybe to follow up on the question regarding raw material inflation. I was just wondering if you can talk a little bit about what you're seeing in aluminum markets. And could that possibly be a source of some raw materials relief at some point later in the year?

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

We do buy a lot of aluminum and aluminum compounds. The concerns that developed last year about the aluminum market have significantly dissipated, as you probably know. And while we're seeing some inflation, it's certainly not the level of inflation that we saw last year.

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

Okay. And then I was also -- I hate to be the one to ask about this, but can we just get an update on your major Middle Eastern customer and plans for commercial sales during 2019?

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

You bet, I appreciate the question. Our expectations haven't changed. We expect that unit to start up this quarter, I mean, in Q1, and we expect to resume a commercial supply in Q2. And the -- our intention in terms of how we monetize that opportunity is really through mix shift. There may be a small amount of volume improvement, but we're really going to use this as an opportunity to upgrade our portfolio and drive positive mix in margin.

Operator

And our next question comes from Ben Kallo with Baird.

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

Can you talk a little bit about your CapEx plans, growth CapEx for the year? And specifically to your work, where do they go by segments? And then just, could you talk about your leverage ratio and how you think about your target ratio? And then if we should expect this growth going forward to this year, at least the organic, or are you still out in the market looking for opportunities?

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

Sure. So on the capital side, we are investing in growth opportunities in all of our businesses. But the biggest investments are in Specialty Catalysts and Materials Technologies, Specialty Catalysts a little more than Materials Technologies. This is a program that we began last year. It will continue this year. And some of these investments won't start up until 20 -- next year 2020. We want to make sure that we've got the right capacity in the right places, and it's important. I hope everybody took note of one of the comments we had in our prepared remarks. About 90% of this growth capital is connected to specific customer investments, customer contracts or licenses. So we feel quite confident making these investments at this time. From a leverage perspective, our long-term leverage target is between 2 and 3 turns, and we've been above that off and on in the last couple of years as we've made these acquisitions, and then we've come back below that target after each of the acquisitions. And in 2018, of course, we bumped up with the acquisition in the polyolefin catalysts business, and we expect to be back below 3x during the course of 2019. Long term, we think that's the right place for us. But when there is a strategic opportunity for us, we're quite comfortable going above 3x in the right situation. In terms of M&A generally, it is part of our long-term growth plan. It's a big part of our history as a company. I think it's part of our future. We are spending time in all of our businesses looking at opportunities. We've spent more time in Materials Technologies in the last year than in any other segment, not counting the one acquisition we actually did in FC, but MT has a lot of promise for us, and it's an area where we've spent a lot of time, and we want to spend even more time in the future.

Operator

And I'm showing no further questions in the queue at this time. Ladies and gentlemen, thank you for your participation in today's conference. This does conclude your program, and you may all disconnect. Everyone, have a great day.