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GRA - Q2 2012 W. R. Grace & Co. Earnings Conference Call

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OVERVIEW:

Co. reported 2Q12 sales of $827m and adjusted diluted EPS of $1.14.

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Rob Walker *Jefferies & Company - Analyst*

Michael Sison *KeyBanc Capital Markets - Analyst*

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

Dana Walker *Kalmar Investments - Analyst*

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David Hahn *PGI - Analyst*

PRESENTATION

Operator

Food Good day, ladies and gentlemen, and welcome to the Q2 2012 W.R. Grace & Co. conference call. My name is Reggie, and I will be your on operator for today. At this time all participants are in a listen-only mode. (Operator Instructions). As a remind they are call is being recorded for replay purposes.

I would now like to turn the call over to Mr. Mark Sutherland, Vice President of Investor Relations. Please proceed, sir.

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

Thank you, Reggie. Hello, everyone, and thank you for joining us today, July 25, 2012, for a discussion of Grace's 2012 second quarter results released this morning. Joining me on today's call are Fred Festa, Grace's Chairman and Chief Executive Officer, and Hudson La Force, our Senior Vice President and Chief Financial Officer. Our earnings release and he corresponding presentation are available on the website. To download copies, go to grace.com and click on investor information. The links are available at the upper right-hand corner of the page.

As you know, some of our comments today will be forward-looking and are made under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected or implied due to a variety of factors. Please see your recent SEC filings for more details on the risks that could impact Grace's future operating results and financial conditions.

We will also discuss certain non-GAAP financial measures, which are described in more detail in this morning's release and on our website. Reconciliations to the most directly comparable GAAP financial measures and other associated disclosures are contained in the earnings release and on our website. Our comments on forward-looking statements and non-GAAP financial measures apply both to the prepared remarks and to the Q&A.

We want to remind everyone that this webcast contains time sensitive information that is accurate only as of today. Any redistribution, retransmission or reproduction of the call without Company consent is prohibited.

With that, I will turn the call over to Fred.

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

Good. Thanks, Mark. And hello to everyone on the call. We start with our second quarter results were strong, and I'm pleased on how we performed. I would like to highlight three components of our results.

First, we had solid growth in our businesses, with base pricing and sales volumes growing more than 7%. Second, I'm very pleased with our results in the emerging regions. Sales in emerging regions grew more than 13% and now are over 36% of our total sales. More than one third of our Company is growing at double digit rates due to increased customer adoption and market penetration. To me this reinforces the fact that we are properly positioned with the right products, the right customers, and the right regions to grow at the rates necessary to meet our 2014 adjusted EBITDA goal of $850 million.

Third, we had strong margins due to continued focus on items above and below the gross margin line. Gross margin continued at the high end of our target range of 35% to 37%. For the first six months of 2012 our gross margin of 36.8% is 60 basis points better than full year 2011 and 130 basis points better than full year 2010. Adjusted EBITDA margin was 21% for the quarter.

I'm also pleased with the strong margins in the materials, technologies and construction products segment. As you remember, we stumbled a bit in material technologies in Q1. In Q2 we improved our performance with targeted sales gains, operational improvements and cost controls, and our operating margin improved 380 basis points sequentially. Construction products had higher sales volume, which translated into better operating leverage and higher margins. Gross margins were 35.1% and operating margins were 13%.

We achieved these results in an operating environment, which is clearly more difficult than we initially projected for 2012. The most significant change and challenge to our original plan is the uncertainty coming from Europe. We saw this in weaker end market demands and unfavorable currency impacts. We also lost some FCC catalyst sales due to refinery closures in the mature markets. These closures are part of the global shift in refining capacity to the emerging regions, where demand for transportation fuels is growing the fastest.

We have anticipated this trend and planned to add FCC catalyst capacity in Abu Dhabi and China in response. As the industry works through this regional shift of capacity, we will see some short-term impact to the sales, but we are confident in our ability to maintain our industry leadership position, given our strong value proposition and global presentation. Our businesses are managing well in a more challenging environment, and we affirm our full year outlook for adjusted EBIT in the range of $510 million to $530 million.

Let me discuss some of the factors driving our confidence in the second half. We see continued sales volume growth in FCC catalyst. Strong sales of polyolefin and chemical catalyst and higher earnings growth in our ART hydroprocessing catalyst joint venture. We expect continued progress in material technologies, with good earnings growth over full year 2011. Volume growth in construction products should continue, although it the a slower rate than in the first half, and we will continue to focus on expense control, balanced for the investments needed to sustain our growth. We like how we are positioned and our business leaders are focused and ready to deliver.

I would now like to update you on the recent developments in our bankruptcy. In our February call we advised that we had satisfied the legal requirements of the bankruptcy code by having our joint plan of reorganization approved by both the bankruptcy court and the US District Court. Since then, we have been waiting to see what appeals will be made to the Third Circuit Court before making an emerge against decision. We were delayed by more than four months by a motion of reconsideration that was favorably resolved on June 11, resulting in a final deadline of July 11 for filing appeals to the Third Circuit.

As expected, a number of appeals were filed. None of them are new. The arguments already have been considered and rejected by both the bankruptcy court and the District Court. We expect three of the appeals will be withdrawn once the Libby settlement agreements are fully affected.

Based on our review of these appeals, Grace has made the decision to seek to emerge from bankruptcy. We believe that the risk of any of these appeals will succeed is remote, and we believe that the legal and economic benefits of emerging with these appeals outstanding are greater than the benefits of remaining under Chapter 11 protection. It is due time to put the plan into effect so the funds can flow to claimants.

However, in order to emerge with the appeals outstanding, we will need approval of our co-proponents and waivers by Sealed Air and -- we have begun discussions with our co-proponents and with Sealed Air and Fresenius of certain conditions in the respective settlement agreement. We have begun discussions with our co-proponents and with Sealed Air and Fresenius. To be confident of emerging this year, theparties need to make a go decision by early September.

Thanks, and I will now turn it over to Hudson to provide more specifics on the quarter.

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

Thank you, Fred. Please turn to pages four and five, and we will start with a quick review of Grace's overall results for the quarter. Page four shows the four key measures we use to evaluate our performance, and page five shows additional year-over-year and sequential comparisons.

Sales in the quarter were $827 million, unchanged from last year. Organic growth of over 7% was offset by unfavorable currency translation of 4% and lower rare earth surcharges of 3%. Almost 5 points of the organic growth was due to improved base prices achieved across all three of our businesses. Sales volumes grew about 3%, led by double digit growth in polyolefin catalysts and high single digit growth in construction products.

Gross profit held steady at $304 million, as improved pricing and productivity gains were offset by higher raw material costs and higher manufacturing costs in our catalyst and materials businesses. Gross margin was 36.8%, down 10 basis points year on year and up 10 basis points sequentially.

Adjusted EBIT increased 8% to $144 million, driven by higher segment operating income in construction products and lower corporate expenses, including lower incentive compensation and the initial benefits of our previously announced restructuring initiatives. Adjusted EBIT margin increased to 17.4%, and adjusted EBITDA margin improved to 21%, an increase of 130 basis points year on year and 230 basis points sequentially.

Adjusted free cash flow was $147 million for the first six months, compared with $60 million last year. The increase in cash flow was due to higher operating earnings and reduced working capital requirements. Adjusted EBIT ROIC was 36% on a trailing four quarter basis, compared with 30% in the prior quarter. Adjusted EPS increased 3% to $1.14 per diluted share. Adjusted EPS growth reduced by a 5% increase in our book effective tax rate compared with the prior year, quarter and a 1% increase in share count. I will talk more about the tax impact later in my remarks.

So let's turn to catalyst technologies on page six. Catalyst technologies includes our FCC polyolefin and chemical catalyst. Our share of ART's earnings are also included in this segment's earnings. Second quarter sales for catalyst technologies were $329 million, down 2% from the prior year quarter. Base pricing and sales volumes increased 10%, but were more than offset by lower rare earth surcharges and unfavorable currency translation. The increase in base pricing was driven by adoption of our lower rare earth FCC catalysts, which are now used by about 85% of our customers.

FCC catalyst sales volumes increased in North America and not emerging regions, but not enough to offset a decline in Europe. Several refineries have closed during the last 12 months, reducing sales in the second quarter by about $12 million or 4%. For the year, we expect these closures to reduce sales by over $50 million. We expect to fully offset these lost sales, however, as other customers increase production to meet the global demand for transportation fuels. This process has already begun.

Q2 FCC catalyst sales volumes increased 7% from Q1. Our FCC segment share remains well within its historical range. Sales volumes and pricing for our polyolefin and chemical catalyst increased 17% during the quarter,partly offset by unfavorable currency translations. This growth was driven by strong polyethylene catalyst sales and continued growth in new polypropylene catalyst volume.

Catalyst technologies gross margin was 40.4%, compared with 41.2% last year and 42% in the 2012 first quarter. The decline in gross margin year-over-year and sequentially reflected the effects of two major scheduled maintenance shutdowns in Q2. We added 23 days of catalyst inventory in advance of the shutdowns, which resulted in favorable overhead absorption in Q1, then liquidated nearly all of that inventory by June 30, resulting in unfavorable overhead absorption in Q2. Both turnarounds were completed by quarter end. We see some gross margin impact in Q3, and we expect gross margins to return to normal levels for Q4.

Segment operating income increased one -- sorry, decreased 1.6% on lower sales and lower gross margins, offset by good expense controls. Segment operating margin was 30.5%, an improvement of 10 basis points compared with last year and a decline of 120 basis point sequentially. Our share of ART's net income was $3 million, down $1 million from last year. For the first six months ATR's net income was up 16% year on year. We expect ART earnings growth to be even stronger in the second half.

We continue to expect positive catalyst earnings growth for the year. We expect good base pricing and sales volumes, but total dollar sales growth will be negative due to lower rare earth surcharges, unfavorable currency translation and the refinery closures. These head winds totaled $270 million for the year to catalyst technologies.

Let's turn to page seven to discuss the impact of rare earth in more detail. The chart on the life shows the average China export price for rare earths, and the chart on the right shows the year-over-year change in rare earth prices. Based on current rare earth prices we expect the full year sales headwind to be about $175 million, compared with the $100 million headwind we expected at the beginning of the year. The impact in Q2 was $26 million or 8% of sales. The impact in Q3 will be about $85 million or more than 20% of sales.

As a result, we will report negative year on year sales growth for catalyst technologies in Q3, although we expect sales volumes to be as strong as in Q2. The rare earth headwind in Q4 will be about the same as it was in Q3. In Q1, rare earth was a small tailwind to sales.

There is a lot happening in the catalyst technologies P&L. Let's step back for a moment. Over the last two years, we have made significant improvements in our FCC and polyolefin catalysts businesses, including new products, capital investments, and supply chain and manufacturing improvements. These improvements are producing significant, sustainable results. When we look at our progress over two years, which helps control for some of the ups and downs in rare earth, we have grown sales volumes 10%, improved base pricing 12%, increased gross margin 530 basis points, and increased EBITDA margin 620 basis points. Segment operating income has increased $89 million or 81%.

Let's move to materials technologies on page eight. Second quarter sales for materials technologies were $224 million, a decrease of 4% compared with the prior year quarter. Unfavorable currency translation and lower sales volumes were partially offset by improved pricing. Among our three segments, materials technologies has the highest exposure to Europe and is the most sensitive to destocking by our customers due to the short cycle nature of the business and the higher inventory levels our customers carry. Demand from European customers was weak in engineered materials and packaging, and we saw an unmistakable destocking in May by packaging customers.

Segment gross margin was 33.5%, compared with 33.6% in the prior year quarter and 31.8% in the 2012 first quarter. The sequential increase in gross margin of 170 basis points primarily reflected improvements in operating productivity and pricing. Segment operating margin was 20.7%, an increase of 200 basis points compare prior year quarter and 380 basis points sequentially. We are pleased with the progress in this business. We are executing the improvement plan we discussed during last quarter's call. Sales volumes were up sequentially, including in Asia, and margins were up sequentially.

Please turn to page nine for construction products. Second quarter sales for construction products were $274 million, an increase of 6% compared with last year. The increase was due to higher sales volumes and improved pricing, partially offset by unfavorable currency translations. Construction products achieved its seventh consecutive quarter of year-over-year sales growth, and this was the segment's best quarter for operating income since the 2008 third quarter.

Sales in North America, at 41% of sales, increased 10% year-over-year, led by a multifamily residential and infrastructure projects in the southern US. Sales in the emerging regions, at 33% of sales, increased 12%, led by strong sales performance in emerging Asia, Latin America and the Middle East. Western Europe, at 15% of sales, declined 14%, largely due to market softness in Southern Europe and the UK. Our business in Europe continues to be profitable and has improved due to our restructuring actions, but margins remain dilutive to the segment average.

Segment gross profit increased 9%, and gross margin improved 100 basis points to 35.1%. The increase in gross margin was due to higher sales volumes improved pricing and favorable product mix. Segment operating income was $36 million, compared with $30 million for the prior year quarter, a 20% increase due to higher sales and improved gross margin. Segment operating margin improved to 13%, compared with 11.5% in the prior year quarter.

Let's turn to our outlook on page 10. Our businesses are performing well, with over 7% organic sales growth year-to-date and very good margin performance. But we are operating in a tougher economic environment than we expected at the beginning of the year. The global economy is weaker and the dollar is stronger.

We affirm our full year outlook range, although we now expect to be at the lower end of our range. In April, we expected to be at the higher end of our range. As you know, it is not our policy to update our annual guidance each quarter or to provide quarterly guidance, but we want to be transparent about the pattern we are expecting in our quarterly earnings for the rest of the year. Last quarter we noted that our quarterly earnings profile would be different this year than in 2011, and this continues to be our expectation. Q2 finished stronger than we expected, but Q3 is going to be weaker than we expected a quarter ago.

We expect Q3 sales to be less than $800 million. We expect good organic, but the sales headwinds in Q3 are significant. The total impact from lower rare earth surcharges, the stronger dollar, and refinery closures about $150 million compared with Q3 last year. We expect our gross margins to continue to be at the higher end of our 35% to 37% target range, and we expect our expense productivity initiatives to continue.

When you add all this up, we expect Q3 adjusted EBIT to be lower than Q3 last year and lower than Q2 and Q4 this year. This is an unusual pattern for us. The biggest driver of this atypical earnings pattern is rare earth and the way it runs through our P&L and balance sheet. We expect earnings to follow a more typical pattern next year, as the ups and downs of rare earth will be behind us. We will update and narrow or 2012 outlook range with our Q3 earnings release, and then for 2013 we intend to return to our stated practice of providing annual guidance with a single midyear update.

A few final notes before we open the call for your questions. Corporate costs declined 20% year-over-year and 14% sequentially, reflecting lower incentive compensation accruals and good expense control across the Company. As economic uncertainty increased in Q2, we tightened our belt and accelerated our productivity and restructuring initiatives. Corporate costs will be about 5% lower in the second half than they were in the first half.

On taxes, our book ETR for adjusted earnings for the year is estimated to be 33.5%, up 0.5 points from our expectation at the beginning of the year and up 1.5 points from Q2 last year. Although this high book ETR is dilutive to earnings, we he continue to prioritize our cash tax rate over our book tax rate. Our cash tax rate was 15% for the first six months, and we expect it to be 14% for the full year. We intend to continue our strategy of maximizing the present value of our tax attributes, including the NOL we will generate in emergence.

If we emerge from bankruptcy at year end, we expect our exit financing requirement to be less than $400 million, including the effect of the announced acquisitions we completed or expect to complete in the second half. This estimate does not include any financing required to settle the warrant.

With that, we will open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of Laurence Alexander of Jefferies. Please proceed.

Rob Walker - *Jefferies & Company - Analyst*

Good morning. This is Rob Walker in for Laurence.

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

How, Rob, how are you?

Rob Walker - *Jefferies & Company - Analyst*

Good. First, I guess the materials tech was quite stronger that the quarter than we expected. What drove the strength? Was it simply improved silica catalyst technologies utilization rates? The new facilities in Asia and South America? And then can you talk briefly about the outlook in that segment in Q3 and Q4?

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

Rob, it was a combination of all. We stumbled a little bit on the operational manufacturing side of it. We got that behind us in Q2. We improved our volume in Asia in a couple of the segments with some of the new products that we have. And thirdly, it was the result of some pricing actions that we were able to achieve in those markets. When I look at the first half of 2012 versus the second half on the whole materials side, we will be stronger, both on volume as well as profitability.

Rob Walker - *Jefferies & Company - Analyst*

Okay, thanks. Around then in terms of -- I understand the impact of the turnarounds resulted in catalyst gross margins being down sequentially, and that they are an impact year-over-year. But with base prices up about 8% and then a positive mix shift towards polyolefin catalysts, why would gross margins be down year-over-year? And then kind of kind of parsing your outlook from Q3 and Q4, I guess do you expect catalyst profit to be up sequentially in Q4 versus Q3? And then is that just all rare earth, or what else is going on?

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

Rob, it really is the effect of these turnarounds. I think maybe the point that will add some perspective on this, we turned around both our Worms facility and Lake Charles facility in Q2. For everybody, these are the two largest manufacturing plants we have in catalyst, and these were extensive turnarounds.

We built 23 days of inventory going into the turnarounds. Most of that build was in Q1, and then we liquidated all of that inventory in Q2. So our days of inventory in catalyst went from 60-some odd days to 80-some ought days back to 60-some odd days, and it is driving a pretty big effect.

I think the second part was about Q4 versus Q3. Yes, we expect improved profitability Q4 from Q3.

Operator

Your next question comes from the line of Mike Sison of KeyBanc. Please proceed.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Good morning, guys. Nice quarter.

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

Thanks, Mike.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Fred, I just wanted to understand your comments on the bankruptcy. You mentioned that you've made the decision to exit. You have got to talk to your co-proponents, and that maybe early September you can officially make the go decision. Just so I understand, what needs to happen between now and then to give you the comfort to go ahead?

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

Well, let me just reaffirm. We believe it is in Grace's best interest to emerge, even with these appeals outstanding, from both a legal perspective -- it will enhance our legal position. We have been debating this, arguing this in court for so many years, and the best way to support it in your legal position based on your advisors is put the plan in effect and show that the plan is fair and pays out the way it said it is going to do. So that is one of the big drivers.

The second driver is obviously Sealed Air and Fresenius have to make -- are part of the plan and have to make a contribution to the plan. So we need approval not only by our co-proponents, which is the ACC and futures representative, but we need Sealed Air to evaluate it. And again it is early in the process, so evaluate it and agree -- Sealed Air and Fresenius -- and agree to waive their conditions. Because their conditions are very clear in the settlement agreements.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Okay. Great. Then in terms of -- the base pricing continues to be impressive for catalyst technologies. You have talked about rare earth coming down. Has the new technology pretty much stuck firmly within customers in terms of lower rare earth products that you bought out over the last year?

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

Yes, absolutely. Absolutely. I think Hudson said 85%, and we feel good about that, and we are in the process of looking at some other new products as well. But the underlying performance has clearly been demonstrated.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Great. And then finally you talked about ART getting better in the second half of the year. Is that more order timing third -- second quarter looked a little bit light versus first. Do you have a pretty good backlog there?

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

Yes, we do. We feel very good about the fixed bed and the resid bed -- or ebulating bed side of it. Those orders are easily seen, and we are seeing good demand in the hydroprocessing side, the distillate side. And the combination of that will give us -- gives us that confidence for the second half.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Great. Thank you.

Operator

Your next question from the line of Chris Shaw of Monness, Crespi. Please proceed.

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

Good morning, guys. How are you doing?

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

Hey, Chris.

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

I thought some of the comments -- early on, you were talking about construction that -- I guess I just wanted to see what you guys think about the trends there, and mostly North America, I guess. Is that something that you think is going to be as strong the second half? I thought there was comment that you thought it was going to get weaker in the second half. I just want to clarify what you guys said there.

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

We have been pleasantly -- this is Fred. We have been pleasantly surprised with the strength in North America and the Americas in general on the construction side. There is just a lot of economic turmoil bouncing around, and there's a lot of cautiousness in the papers and so on. And as you know, in the construction chemical side we don't have as long visibility as we would do in the are ART side of it. We are just being maybe a little bit cautious that it could be slightly weaker, North America. I mean, Europe -- as we said in the call, Europe is down 14%, 15%, and we don't see -- and we are not planning any recovery in Europe in the second half. And across Asia we have continued to do well, both in the emerging parts of Asia as a well as the more established regions of Asia.

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

That is fair. And then I guess the -- since we're on construction, the deal you guys did in, was it Brazil? Rheoset?

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

Yes.

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

What is the size there? Is it small -- really small, or will be adding?

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

Like our typical bolt-ons that we have done. It's small. It's small. But it gives us a nice position in that market, with what we have been able to build over the last couple of years, to take advantage of all of that building that is happening with the Olympics and the World Cup. It is right in Rio, so.

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

Right. Then looking at the reaffirmation of the guidance. I guess as you took down your expectation, at least of the second half, of where currencies were are going to be, or I guess euro in particular, $1.22 is what you are using for the second half. And I know, I think, initially your guidance had $1.30 number for euro. What making up for that? Is it the cost cutting, or is ti underlying volumes a little stronger than you expected at the beginning of the year?

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

Chris, we are seeing -- it is really all of those things. We are pulling the levers that we have. Volume performance has been good. Pricing performance has been good. We did tighten our belts in the second quarter around expenses and things like that, so we are working every part of the P&L to get the best result.

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

Great. Sounds good. Thanks.

Operator

Sir, you have no questions at this time. (Operator Instructions). Your next question comes from the line of Dana Walker of Kalmar Investments. Please proceed.

Dana Walker - *Kalmar Investments - Analyst*

I would be happy to proceed. Good morning.

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

Hi, Dana.

Dana Walker - *Kalmar Investments - Analyst*

Hudson, would you expand upon the role -- or the way the rare earth ups and downs flow through the balance sheet and the income statement?

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

I will, Dana. I don't want to do an accounting lesson, but let me hit some of the broad pieces. This has to do with inventory cap, and the days on hand of inventory, and the days on hand of rare earth that we are holding. And as we managed through this over the last -- what has it been now, six or seven quarters, I guess -- we have seen a high run-up in rare earth. It has come back down.

At different points in time we have different days on hand of inventory, and so you have got two or three or four variables that are all moving, being driven by rare earth market costs swells as well as manufacturing inventory supply chain decisions that we have been making. And basically when you put all that into the inventory capitalization models, it is what moves dollars from quarter to quarter, things that get capped up and move inside the next quarter. So it doesn't always mirror the cash flows that are running through the business according to sales and purchasing decisions.

I don't know if that makes it clear or less clear, but that is what is happening, Dana.

Dana Walker - *Kalmar Investments - Analyst*

That is qualitatively helpful. If we were to compare the amount of working capital, net of payables, that you had tied up in rare earths at the peak versus where it is likely to end this year, what change in cash tied up in the business is that likely to lead to?

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

I don't have a precise number, but order of magnitude it is $100 million or more. It could even be $200 million . It is a very big number.

Dana Walker - *Kalmar Investments - Analyst*

Fred, if you were to comment to the degree that this is possible on a public forum, whether Fresenius and Sealed Air would be of like minds in having you exit at this time, would you do that? Or is that tough to do?

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

No, I wouldn't don't that. It wouldn't be fair. It wouldn't be fair to Fresenius and Sealed Air. They will -- they have been close to the gates and very good supporters of ours, and they will review it and come back with a decision. And there will be dialogue around it.

Dana Walker - *Kalmar Investments - Analyst*

Final question relates to the refinery closure effect of $50 million. I presume that is visible close retractor, and if there were to be gains, which would be harder to pinpoint as volumes would pick up at other locations, that number would lessen that $50 million, and yet knowing what that net number is likely to be is tough.

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

You are exactly right, Dana. The gross effect of the refineries that have closed. Obviously we are working to replace that volume, and we have replaced some already. It is sequentially from Q1 to Q2, FCC catalyst volumes improved about 7%. Some of that was replacing closed -- volumes from closed refineries. Some of it was natural growth that we would expect.

The point I think is that we have the footprint so that as our customers shift their refining capacity out of North America and Europe into the Middle East and Asia, we are working to follow them. And it doesn't happen immediately. A refinery closes in Europe, and it may be a year or more that replacement capacity comes online in another region. But we have got the footprint -- commercial and technical footprint, and we are working on having the manufacturing footprint to follow that demand shift.

Dana Walker - *Kalmar Investments - Analyst*

Is there -- what level of confidence should there be about your ability to capture like share of the refinery closure volumes lost as that reappears elsewhere?

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

We are highly confident.

Dana Walker - *Kalmar Investments - Analyst*

That comes because of product specialization and -- or would it just be because of your share of market and your ability to likely sustain share of market where it rematerializes?

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

It is both of those factors plus the historical position we have in those regions. These are not new regions for us. We have operated in the Middle East and Asia for many, many years, and we have a very strong commercial and technology footprint in those regions.

Dana Walker - *Kalmar Investments - Analyst*

Good stuff. Thank you.

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

This is -- FCC is probably the most globally mature business that we have.

Dana Walker - *Kalmar Investments - Analyst*

All right. Keep up the good work. Thank you.

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

Thank you, Dana.

Operator

Your next question comes from the line of Rosemarie Morbelli of Gabelli & Company. Please proceed.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Regarding your emergence from bankruptcy, could you remind us of which conditions needs to be waived by Sealed Air and Fresenius in order for you to do it?

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

Well, the conditions are really the conditions that they -- that were agreed in the original settlement, and that is that there are no appeals to the -- that no appeals are left to the plan. So it is basically a complete and appeal-free plan.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Would that take away more or less -- and I'm not sure how to phrase this, but take away the fact that they cannot be sued by any of the plaintiffs once you are out of bankruptcy and they have agreed to the conditions?

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

Yes, that is exactly true. That gives them finality and certainty.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. So they would have to agree to eliminate that certainty. Am I correct in understanding what it is?

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

I'm not sure I'm following exactly your question. They would have to agree to waive the condition, and again it depends on what specific conditions, so I'mnot I'm not exactly sure how to respond to that.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. So that would mean that the door open for them to be sued would remain open?

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

No, that is not the case. What they would waive is the condition -- they would fund the plan with the appeals outstanding, because they believe -- if they believe that it is in their best interest for this plan to be confirmed, so -- Go ahead, Hudson.

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

Let me see if I can kind of package it. Our plan and the Sealed Air and Fresenius agreements contemplated a final nonappealable order. We are not at that point. We've made the decision -- Grace made the decision that we improve our legal position and we benefit economically by coming out now, emerging even though some appeals are still outstanding.

Sealed Air and Fresenius, their settlement agreements also said that our plan would be final and nonappealable. We are not quite to that point yet. They need to make a decision -- alegal decision and economic decision whether they agree or not with our assessment that we improve our position by coming out now. Is that -- did I capture it better, Fred?

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

We believe that by emerging with the appeals outstanding improves our legal position to get a final plan approved. We believe by putting the plan in practice and operating that plan, that it demonstrates and removes the vagueries of the legal appeals that have been thrown -- have been up there for a number of years.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. Thank you. That is helpful.

Operator

Your next question comes from the line of [David Hahn] of [PGI]. Please proceed.

David Hahn - *PGI - Analyst*

Hi, this isa very good quarter. Congratulations. Can you comment on FCC versus HPC towards the second half?

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

Our FCC volumes will be up, and HPC volumes will be up as well. Because of the lumpiness in ART, the second half will be stronger than the first half in HPC.

David Hahn - *PGI - Analyst*

Okay. Thank you.

Operator

At this time you have no further questions. I would now like to turn the call back over to management for closing remarks.

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

Reggie, thank you very much. And thank you to all who joined us this morning. Before signing up I would like to leave you my telephone number for direct follow up. 410-531-4590 for any follow-up or clarification to questions. Thank you very much and have a good day.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a great day.