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Q1 2019 W. R. Grace & Co Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Q1 2019 W.R. Grace Earnings Conference Call. (Operator Instructions).

I would now like to turn the conference over to your host, Jeremy Rohen, Vice President of Corporate Development, Investor Relations.

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

Thank you, Bella. Hello, everyone, and thank you for joining us today for Grace's first quarter 2019 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 business and actual future results may differ materially. Please see our recent SEC filings, which identify the principal risks and uncertainties that could affect future performance. We will discuss certain non-GAAP financial measures, which are described in more detail in this morning's earnings materials.

Reconciliations of non-GAAP financial measures and other associated disclosures are contained in our earnings materials and posted on our website.

This morning, Hudson will address our first quarter business performance and key developments for their strategic priorities. I will then cover our financial results and provide an update on the second quarter and full year outlooks.

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

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

Thank you, Jeremy. Good morning, everyone.

Our team delivered another strong quarter of solid sales and earnings growth. We made significant progress with our strategic growth investments in our commercial and operating excellence initiatives.

For the quarter, sales were up 9% with both Specialty Catalysts and Materials Technologies delivering high single-digit organic sales growth on a constant currency basis. Overall, we continued to see solid demand in our end markets and experienced good volume growth in North America, EMEA and Asia during the quarter. Our focus on value selling continues to benefit our results.

In the first quarter, we achieved over 200 basis points of improved pricing with gains in every business. Adjusted EBIT was up 9% and adjusted EPS increased 13% driven by the polyolefin catalysts acquisition and our organic growth, which more than offset the headwinds

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from inflation and currency.

For the quarter, our adjusted EPS was slightly above our outlook range, largely due to order timing within the first half of the year. I am confident in our growth, earnings and cash flow expectations for the year. And we are reaffirming our full year outlook. We are focused on capturing and monetizing the growth opportunities we have in managing inventory and spending to ensure we remain well balanced.

Please turn to Slide 5.

Grace's future is anchored in the strong fundamentals of our businesses and the long-term enduring growth drivers underlying the markets and customers we serve. Our growth has long been driven by increased demand for high-performance plastics, cleaner transportation fuels and stricter environmental regulations. As the importance of sustainability continues to increase, our opportunities to create value will continue to grow. Many of our fastest-growing products help our customers improve the efficiency of their processes, reduce energy or water use or cut harmful emissions.

Other products help our customers address rising consumer and regulatory expectations for safe food, clean water and human health and safety. Simply put, our technologies help our customers achieve their sustainability goals.

Last quarter, I highlighted how one of our silica products helped the customer reduce water usage and waste in their operations. This is a product that we expect will grow double digits given the value it creates for customers.

On a much larger scale, our entire hydroprocessing catalyst business is growing high single digits on the demand for cleaner fuels. Our catalysts significantly reduced the amount of sulfur and other contaminants in transportation fuels, helping minimize their environmental impact. We recently highlighted our initiatives to reactivate and recycle, spend HPC catalysts, expanding on existing catalyst-recycling efforts to improve the sustainability of our products. Sustainability is important to us as a company and we remain committed to doing our part.

Shifting to investments in operations. In February, we announced we were building a new manufacturing plant in Europe to support the growing global demand for our LUDOX colloidal silica technology. LUDOX is in high demand for use in emissions control catalysts, to address tighter regulatory requirements and in specialty coatings for applications like corrosion resistance and any abrasion. This capacity investment is timed and sized to meet identified customer demand. As we commented last quarter, over 90% of our current growth capital investments are tied to specific customers, contracts or licenses. Operating excellence and the gross -- Grace Manufacturing System continued to improve operations through increased production rates, improved reliability and lower costs.

In 2018, GMS produced a 50 basis point benefit to gross margin, some of which dropped to the bottom line and some of which we reinvested to support future growth. For the next several years, we expect similar annual benefits.

I'll give you an example of a typical GMS implementation. Last year, we began a GMS implementation at one of our sold-out units. During the project, the manufacturing team upgraded a challenging manufacturing process step and strengthened their maintenance strategy. The project took about 6 months and was completed in Q4. In the first quarter, the changes resulted in an 8.5% increase in production rates versus the prior year. Like most of our GMS investments, this investment will pay back in less than 1 year.

Now let's turn to Slide 6 and look at our first quarter business performance.

Catalyst technology sales were up 11% driven by solid demand for our leading technologies and improved pricing, partially offset by currency headwinds. In Specialty Catalysts, organic sales were up 8% and total sales were up 27%, including the polyolefin catalysts acquisition. We continue to see strong demand for our catalyst products as customers add capacity to support long-term demand for polyolefins and seek to maximize the value of the resins they produce.

We are encouraged by the robust pipeline for our UNIPOL process technology driven by the growing global demand for polypropylene resins.

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We've passed the first anniversary of the polyolefin catalysts acquisition, and I'm very pleased with the results of this investment. In the first 12 months, the acquisition generated over $110 million in sales at margins in line with our catalyst segment.

Today, the business is fully integrated into Specialty Catalysts and is delivering the capital and costs synergies we expected. The synergies will be fully realized by the end of 2019 and will result in a post-synergy purchase price multiple, more than 3 turns below the announced multiple.

Long term, the combined commercial and R&D platforms will further strengthen our customer relationships and innovation capabilities and enable Specialty Catalysts to continue to grow at high single digits.

In Refining Technologies, sales were down $1.6 million due to weaker MTO catalyst sales and unfavorable currency. FCC catalyst sales volumes were up low single digits and FCC catalysts pricing improved more than 200 basis points on a trailing 12-month basis. Our pricing expectations remain 1% to 2% per year over the long term.

ART continues to see strong demand for HPC catalysts, and we expect this to continue as the demand for cleaner fuel increases and IMO 2020 is implemented.

Last, I am pleased to report that the Middle East FCC customer restarted operations in the first quarter. We have now resumed normal supply to them.

Let's turn to Materials Technologies on Slide 7.

We continue to experience solid demand for our products led by the consumer, pharma and chemical process end markets. Higher volumes and improved pricing contributed over 8% to sales growth. This more than offset a 5% impact from currency in the expected weakness in the China coatings market we discussed last quarter. The China coatings market has started to stabilize for us. Importantly, this market is less than 4% of MT sales. We expect the strong demand we've experienced in materials to continue, driven by consumer, pharma and chemical-process segments in North America and EMEA.

The Materials Technologies team continues to execute on its strategy to optimize its portfolio by focusing on faster growing, more strategic markets. We expect these attractive end markets to contribute nearly 2/3 of the business' sales growth in 2019.

We have strong businesses with enduring growth drivers, a clear growth strategy and customers that value our technologies. Our value creation model and strong culture make Grace a great place to work.

In a competitive labor market, we've been successful retaining the great talent we have and attracting a significant amount of new talent to Grace. While the CFO search has taken longer than I wanted, I am comfortable with where we are in our search. We have a strong existing team that serves me, our business leaders and investors well.

I'll now turn the call over 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.

Turning to Slide 9, Grace had another solid quarter with sales of $479 million, up 9% and up 11% on constant currency.

Organic growth was driven by higher sales volumes and improved pricing in both Catalysts Technologies and Materials Technologies. This more than offset the 2.5% impact from unfavorable currency, which was largely driven by the strength of the U.S. dollar versus the Euro. And as we've said before, approximately 95% of our sales are linked to the U.S. dollar or the Euro.

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Adjusted gross margin for the quarter expanded 80 basis points through our focus on value selling and broader commercial and operating excellence initiatives, which more than offset 120 basis points of inflation.

Sequentially, adjusted gross margin was up 260 basis points, returning to normal levels following our decision in the fourth quarter to proactively reduce production rates and accelerate certain product trials. As we discussed at that time, the actions did not impact the first quarter.

Adjusted EBIT was up 9%, and adjusted EBIT margin of 22.2% was flat year-over-year. Adjusted EPS for the quarter was $0.93 per share, up 13% and slightly above our outlook primarily due to order timing in the first half of the year.

Now let's turn to Slide 10.

We continued to deploy our capital to fund our strategic growth investments, pursue bolt-on acquisitions and return capital to shareholders. We are confident our focus on disciplined capital allocation will deliver profitable growth and create shareholder value.

For the quarter, we invested $50 million of capital in our plants and are on track to invest $200 million to $210 million of capitals in our operations this year. We returned $23 million of cash to shareholders through our dividend and share buyback. And we reduced our net leverage to 3.1x with the expectation to be back below 3 by the end of 2019.

Moving to Slide 11, let's take a quick look at our second quarter and full year outlooks, and we'll then open the call for questions. For Q2, we expect adjusted EPS to be up 6.5% to 7.5% year-over-year. Our adjusted EPS outlook for the first half of 2019 remains tightly aligned to our internal expectations from February.

Adjusted gross margin should be in line with the first quarter of 2019 but down year-over-year as the second quarter of 2018 was our strongest margin quarter of the year.

For the full year, we remain encouraged about our business outlook and our position to deliver another solid year of growth and margin expansion. We are reaffirming our 2019 outlook, including 6% to 7% top line growth.

At the segment level, we continue to expect sales growth in line with our prior views, including high single-digit growth in Specialty Catalysts, mid-single-digit growth in Materials Technologies and low single-digit growth in Refining Technologies.

We expect 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 $4.62 per share, an increase of 10% to 12% year-over-year.

The key assumptions behind our outlook remain unchanged and are included on Slide 11. In terms of global macroeconomic risks, we continue to expect full year inflation in the major 100 to 150 basis points and moderate FX headwinds continuing in the second quarter. As a reminder, we have very limited exposure to tariffs, emerging market currencies and interest rates. We closely monitor global market conditions and we'll take any actions necessary to adjust if conditions change.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of John Roberts from UBS.

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

I know consultants have forecasted about how refiners may operate differently as we approach IMO 2020, but do you have any visibility into your order book on how they might react as the year progresses?

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

John, it -- this is the conversation that we're having with our customers everyday right now. And at this stage of the year, it's still a little early for them to make final decisions about what they -- about how they want to run as they approach the end of the year. We're working on giving them options, and I expect they'll start making decisions in Q3 and we would start to see changes in catalyst preferences in that time frame.

Overall, I -- my expectation is that refiners will choose to run hard through the end of this year and into next year to create enough blend-stock to achieve the lower sulfur content, the 0.5% content. They will try to shift their yield away from gas towards diesel, but they're not going to be able to do enough mix shift to create an blend-stock without running hard. That's what it looks like to us right now.

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

And secondly, in the Materials Technologies segment, can you give us a little more color around the 20%-plus growth in the consumer and pharma applications?

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

Sure. This is one of our focused growth segments. I think we've commented over the last year or so about our efforts to shift mix away from some lower-value segments into the higher-value segments in consumer pharma broadly and in some of the individual segments within that business are attracted to us both from a growth-rate perspective and a margin perspective. And we've been shifting R&D dollars in that direction. We've been shifting commercial resources into that direction.

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

Will we anniversary some step-up? And, obviously, I don't think you're going to maintain this, kind of, high growth rate for a long period or maybe you are, maybe your early-stage ramp...

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

No. This is -- if you think about -- thank you, that's a good clarifying question, John. If you think about the sales growth guidance we've given for MT, we've said mid-single digits. Some segments will grow faster, some will grow slower. Overtime, I would expect the consumer pharma business to grow high single digits overtime. And in any one quarter, that might be higher or lower.

Jeremy made the comment in his remarks about order timing between Q1 and Q2. One of the reasons why the Q1 growth was so high in that segment was one of these order timing points, an order that we thought would come in Q2 came in Q1 instead and it was in that segment.

Operator

Your next question comes from the line of Kevin McCarthy with Vertical Research.

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

I was wondering if you could comment on your FCC business, so it looks like the price realizations continue to flow through nicely. What are you seeing with regard to mix there? And I'm asking because we've observed propylene prices come down, oh, I don't know, 40% or so over the last 6 months. Are you seeing any change in behavior among your customers in terms of grades? Or mix of premium products there?

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

We haven't, Kevin. And if anything, we've seen the demand for propylene max products continue to grow. The one thing I'll add, thinking about the point you raised about propylene pricing, the customers that really -- most of our customers that really want to maximize propylene are doing it for strategic reasons not just opportunistic reasons. They're looking to maximize propylene for downstream petrochemical operations. And so they're not going to be sensitive to changes in propylene values.

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

Okay. That's great color. And then, second, I wanted to ask about the ART joint venture. The equity earnings here dipped a little bit. I know that business can be lumpy from time to time. What is your outlook for the second quarter and beyond in terms of HPC volume and order books?

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

Yes. Great question, Kevin. I always think about the ART business on an annual basis because it is very, very lumpy. And the timing of the lumps seems to be different every year. But when we look at -- if we -- when we look at the whole year, we're looking at strong high single-digit volume growth and high single-digits earnings growth as well.

Operator

Your next question comes from the line of Christopher Parkinson with Crédit Suisse.

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

I understand your 1% or 2% long-term guidance range for catalyst pricing, but can you just dig a little bit more into your price or value strategy? How that's going? Competitive environment by region? And just whether or not you believe there are any large -- any medium-term opportunities to attain above average price mix uplift, particularly, as a result of new products?

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

Thanks, Chris. When we look at the long term, and when we say that, we're thinking the 5-year term of our financial framework, that 2016-2021 financial framework that we have. We do expect 1% to 2% pricing throughout that time period. It's going to be higher some years, maybe lower other years. For the last 3 -- I'm looking at Jeremy, 3, maybe 4 quarters now, we've reported better than 200 basis points pricing in FCC catalysts. And I expect that to continue certainly as we look into the rest of this year. That reflects some product mix, to the second part of your question, the propylene max catalysts are high-value catalysts for our customers and that's part of what we're benefiting from as we shift our product mix in that direction and we see a stronger demand growth for those types of products. The relative demand growth for propylene max catalysts versus regular catalysts is probably 3x within our business.

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

And just a quick follow-up. Just given the reduction in leverage towards, at least, the high end of your target. Can you just comment on your appetite for M&A, large and small? And whether or not there are any licensing assets still out there?

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

Okay. Yes, Chris. No, I -- we still remain very active, thinking about M&A opportunities. The appetite that we have for strategic bolt-ons, like the ones we've seen -- we've been able to do over the last few years, remains good. We're doing work in catalysts and in Materials Technologies. And while we have said we want to get our leverage back below 3 turns this year, that objective would not stand in the way of us doing a smart strategic bolt-on.

Operator

Your next question comes from the line of Robert Koort with Goldman Sachs.

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

This is Chris Evans on for Bob. Just regarding your second quarter guidance. You're pointing towards the lowest EPS growth rate in some time now and realizing that you're lapping the Albemarle acquisition and flagged timing but surprised the expectation is a little bit better, given the trend in FCC pricing and potential mix benefits from -- to Korea coming up. Is there anything else we're missing in there?

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

Q2 is the toughest inflation and currency quarter for us. And when we look at the full year, we feel good about our 10% to 12% guidance, EPS growth guidance. But as you look across the 4 quarters, Q2 will be the weaker year-over-year growth quarter for us. The biggest issue is it is the peak quarter for us on year-over-year inflation and on currency.

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

Great. And then, a new HPC plan, I believe, is coming up in the fourth quarter, and I think previously you've said, it should be pretty much sold-out to start. How should we think about the potential financial impact to Grace? And if you can't give specific financial guidance around that, could you contextualize it maybe in broader terms like how much tonnage of catalyst from that versus your current (inaudible)?

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

Yes. The first point I think, is we expect this to start up late in the year with really no financial benefit to 2019. All of the benefit will come in 2020. We'll be more specific when we give our 2020 expectations later this year. But this is -- it's a significant increase in capacity. I think I said once before, it's big but not huge or something like that. It's designed to supply a couple of years of growth and provide enough tonnage for us to supply a couple years of growth.

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

Is there a way you can give percentage increase in your tonnage for ART?

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

We'll give that to you when we get to 2020, when we get to our 2020 numbers. I don't want to get ahead of myself.

Operator

Your next question comes from the line of Mike Harrison with Seaport Global Securities.

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

Hudson, I was wondering if you could comment a little bit on the MTO weakness that you mentioned. Just wondering if China is still committed to this realm for olefin supply? Or are they seeing alternatives that are getting more attractive versus the MTO realm?

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

Well, I -- from a broad-market perspective, I -- there is a lot of capacity in place in China. For the most part, those units are running and they're trying to use this technology as a way to better meet their olefins' requirements internally. The country has an objective of being more self-sufficient in olefins and polyolefins.

For us, our goal in all of our businesses is to make sure we're achieving the right balance between growth and profitability. And that's true in China as it is any place else. We haven't gotten the -- historically, we haven't gotten the margins that we wanted to get in this business. We don't want to get growth just for the sake of growth. And so we're working to find the right balance between growth and profitability in this market.

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

Interesting. All right. And then, was also wondering just in terms of the outlook for FCC with the large Middle Eastern customer coming back on stream, how should we think about that affecting volume and mix? And can you also comment on whether there are some additional costs, any kind of unusual costs associated with restarting the deliveries there?

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

Mike, our strategic intent is to monetize the restart of this operation through mix. You'll see it in mix rather than in volume. And you -- that benefit will start to materialize in Q2.

Operator

Your next question comes from the line of Lawrence Alexander with Jefferies.

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

This is Dan Rizzo on for Lawrence. You mentioned inflation, kind of, peaking in Q2, I was wondering if you could provide color on exactly what -- where the inflation is coming from? And just the outlook as the year progresses?

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

We're seeing it in metals. We're seeing it in caustic. Remember, this is a year-over-year comparison. On a sequential basis, we do expect cost to start to improve in the second half.

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

Okay. And then, I think you said before that in Materials Technologies that you're seeing strengthen in Europe, I was just wondering -- like because, I mean, macro conditions as reported by others, is showing some (inaudible) in that region, I was just wondering why you guys are or how you guys are outperforming? If it is just not something you're seeing and it's -- just given the product mix or what's happening there?

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

Yes, it's -- we've had others ask us the same question, and I don't -- there's not any one end market or segment that I would point to. I think it is a relative concept. We had pretty modest expectations for Europe and they did outperform. We've invested a lot in commercial excellence. We're much more effective at managing our sales pipelines. We're much more focused on driving commercial performance. And I think some of it is just that. But it's not a big difference. It's enough to note, but some of it is against weak expectations for Europe.

Operator

(Operator Instructions) Your next question comes from the line of Mike Sison with KeyBanc.

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

Hudson, when -- thinking about FCC in terms of your operating rates, are you pretty full out? And what's the opportunity to start maybe shaving some of the lower margin business and looking at the bigger projects or higher-margin projects going forward?

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

Mike, just to clarify, you said FCC, fluid catalytic cracking?

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

Yes.

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

Yes. Okay. Good. I just wanted to make sure I understood. No, I - we're running hard. Our intent in this business, our strategic intent in this business is to grow with the market. And the market grows low single digits. We have the capacity we need to grow in line with that market growth rate. We are actively working to shift mix within that portfolio. And we work customer mix, we work product mix, one of the earlier questions was on the advantage of maximized propylene catalysts versus other catalysts. And as we move through the course of this year, we'll continue to do that. The big customer that restarted in Q1, as I commented on a moment ago, we'll monetize that through mix rather than through big volume growth.

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

Great. And then, could you maybe spend a little bit of time on Specialty Catalysts? Its -- the organic growth rate high single digits, not a lot of businesses are doing that. Can you maybe breakdown each of the pieces of that business? And where you see the growth this year and potentially longer term?

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

Sure. I appreciate the question, Mike. So we do see high single digit growth in this business. It's coming from the polyethylene side. It's coming from the polypropylene side. It's coming from licensing. And it reflects a couple of different things I think. There's a strong underlying growth rate in this business. Plastics are still growing 4% to 5%., at least polyolefin plastics are still growing at that rate. We get a growth benefit on top of that because of licensing. Not just the licensing revenue itself, but I think the licensing capability gives us an advantage even when we're selling catalysts. It just -- it changes the relationship with our customers in a positive way and I think it gives us an advantage in catalysts.

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The other important part of the higher growth rate is the breadth of our portfolio. With the acquisitions that we've made over -- well, I guess, it's close to 6 years now, 5.5 years. 3 big acquisitions, we've built out a very complete, very comprehensive catalyst portfolio on both polyethylene and polypropylene. It makes us a more valued -- a more valuable innovation partner to our customers. And we've learned a lot about catalyst technology and innovation by adopting the best practices of the businesses we've acquired, with the early ones, the UNIPOL acquisition and the BASF acquisition. We're far along in terms of those acquisitions benefiting our R&D pipeline and so forth. With the acquisition we made last year, we're really just getting started on capitalizing on the R&D synergies and the commercial synergies. So I'm very high on this business and it's a good strategic business, it's in a good strategic spot with good growth opportunities.

Operator

(Operator Instructions) We have a follow-up question from Mike Harrison from Seaport Global Securities.

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

Just one quick additional question. You announced their collaboration with TechnipFMC on FCC technology in that max propylene segment. I was just wondering if you could help us understand how this DCC technology fits in with your existing max propylene catalysts? And how it helps to enhance your position within FCC?

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

It really is what you just said, Mike. It's a way to enhance our technical capability in the max propylene segment. The DCC process technology is a max propylene technology. The idea is for us with catalyst expertise and Techninp with process expertise to collaborate instead of us innovating on process and catalyst separately to innovate together and understand the interrelationship between the process and the mechanics on the one hand and the catalyst on the other. It's something that we're, obviously, just getting started with. But we find it very, very interesting.

Operator

Your next question comes from the line of Chris Kapsch from Loop Capital.

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

Yes. I had a follow-up question on, Hudson, your comments about your discussions with customers, refining customers around how they -- their configurations going into and ahead of IMO 2020. I think we all understand that there's going to be more HPC processing. I think you said, though, they expect to maybe shift the yield [slate] a little bit from gas towards diesel to build some blend-stocks. Can you just talk about if that's the way it plays out, what do you think the implications are for the FCC unit at these refiners? And, therefore, implications for either FCC demand or FCC mix over the balance of '19 and then into 2020?

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

Yes. Chris, thanks for the question. The -- we think they're going to run their FCC units hard this year to create enough -- basically, to create enough blend-stock. And that's obviously good for us. There will be some catalyst reformulations. There's not a big profitability difference between a gasoline-oriented catalyst or diesel-oriented catalyst. So we don't expect an effect that way. But we do expect the refiners to run hard in general and we expect them to run their FCC units hard.

Operator

Your next question comes from the line of John McNulty from BMO capital.

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

With regard to the Materials Tech business, you showed some solid volumes and some pricing in it, it really didn't flow through in the margins. I guess, you've articulated there was certainly some investment there, I guess. Can you speak to that level of investment that you're putting in there? And when we might be able to see an inflection point in terms of how the margins progress higher going forward?

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

Yes. John, thanks for the question. We're investing in the manufacturing plants to make sure that we create the capacity we need to sustain these growth rates. That's not just new capacity but debottlenecking and GMS-type projects and so forth and so on. So some of that investment is in the gross margin line and some of it is at the OpEx level as we've added a sales and marketing resources, I think, we called it Commercial Excellence in the script to make sure that we've got the commercial organization we need to continue to drive that growth. We are still in a net-investment mode at this point. I think by the second half of this year that'll start to turnaround.

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

Got it. And then, I guess, I was a little -- just was a little curious on -- you indicated that raw material headwinds were going to be, at least, year-over-year the fiercest this quarter. Is that just because of the timing of when some of the hedges you have in place, kind of, roll through and maybe some -- we're kind of seeing some of the heavier costs from last year still, kind of, in there? Because it does seem a little bit odd, given a lot of the [raws] that you're tied to seem like they're actually lower at this point. So, I guess, how should we think about that?

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

Well, it's -- what has happened is on a cash basis -- to be fully transparent, on a cash basis, the cash costs probably peaked in Q1. But a lot of that cost gets inventoried and it'll come through in Q2.

Operator

And we have a follow-up question from Robert Koort with Goldman Sachs.

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

Just wanted a follow-up. In MT, could you give a little color on, I guess, the little bit of a step-down you saw in sales of the coatings customers. I think you flagged China in the release and your read on the second quarter or beyond?

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

We -- so on a year-over-year basis, the China coatings market was weak for us in Q4 and in Q1. We see it stabilizing right now. And so when we look sequentially from Q1 to Q2, we see -- at least, post-Chinese New Year, we see a more stabilized market. But on a year-over-year basis, we did definitely see a headwind in Q4 and Q1.

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

And then, in your Refining Tech business, you're flagged in the MTO declines offsetting favorable price and volumes for FCC, which -- my understanding is a much larger business than MTO. So in that context, I guess, could you contextualize how big of declines you actually saw at MTO to partially offset the favorable business you saw in FCC?

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

Yes. I -- Jeremy, have we quantified MTO before?

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

No.

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

Chris, your intuition is right. It is a smaller business, a significantly smaller business than FCC catalysts. And your intuition is right. it's a fairly large percentage change on a smaller business to show up at the total level.

Operator

I'm showing no further questions at this time. I would now like to turn the conference back to Jeremy Rohen.

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

Thank you, Bella. Thank you, everyone, for your time today and your interest in Grace. We look forward to seeing many of you at upcoming conferences including Goldman Sachs and KeyBanc in May and Deutsche Bank and Vertical in June. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may all disconnect.

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