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GRA - Q2 2016 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 2Q16 sales of $390m and adjusted diluted EPS of $0.74. Expects 2016 adjusted EPS to be $3.05-3.10.

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Bob Koort *Goldman Sachs - Analyst*

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

Jim Barrett *C.L. King & Associates - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the W. R. Grace & Company second-quarter 2016 earnings conference call. (Operator Instructions) As a reminder, today's conference call is being recorded.

I would now like to introduce your first speaker for today, Tania Almond, Investor Relations Officer. You have the floor, ma'am.

Tania Almond - *W.R. Grace & Co. - IR Officer*

Thank you, Andrew. Hello, everyone, thank you for joining us today on August 1, 2016. With me on the call are Fred Festa, Grace's Chairman and Chief Executive Officer; Hudson La Force, President and Chief Operating Officer; and Tom Blaser, Senior Vice President and Chief Financial Officer. Fred will start with the highlights, Hudson will review more detail on the operations, and Tom will go over the financials. Then we'll open it up for Q&A.

Our earnings release and corresponding presentation are available on our website. To download copies, go to Grace.com and click on the Investors tab.

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

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

And with that, I'll hand the call over to Fred.

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

Great. Thanks, Tania, and good morning to everyone. We had another productive quarter, continuing to achieve good margin improvement and strong cash flow. We grew the top line sequentially 8% and delivered $96 million of adjusted EBIT or $0.74 per share.

We had strong margins in both Catalysts and Materials as a result of our productivity programs and deflation. We also deliver the expected sequential improvement in our short-cycle silicas business this quarter.

Additionally, we completed the acquisition of BASF's polyolefin catalysts business on June 30. Grace is now the global leader in polyolefin catalysts and number two in polypropylene process licensing. We have a broad portfolio of products and technologies and are very excited by the growth opportunities they present.

Late last week, we delivered our first shipment of FCC catalysts to the Takreer refinery. The unit is running and the transition to Grace catalysts is underway. We expect to be at full contract volumes in the fourth quarter.

This is a strategically important step forward for our FCC catalyst business. We started this journey when we began repositioning our customer portfolio to make room for the Takreer volumes. At that time, we thought we were just a few quarters away from beginning to supply the refinery.

While the delay has been trying, it has also caused us to take a hard look at our product portfolio, manufacturing cost, and product mix. As a result, our business today is stronger and more profitable.

As for macro trends, slowing growth in China continues to be a headwind and a drag on the rest of Asia. European markets are seeing modest growth. And as for the impact of Brexit on our business, less than 2% of our revenues are sourced from UK customers and less than half of that business is denominated in pound sterling.

For the rest of the year, we will continue to build momentum to take us into in 2017. Our focus is on sequential sales growth, integrating the polyolefin catalyst acquisition, continuing to implement our productivity and operational excellence actions, and delivering strong cash flow to fund growth and return cash to shareholders.

With that I'm going to turn it over to Hudson to give you some more details. Thank you.

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

Thank you, Fred. I'm very excited about adding LYNX polyethylene and polypropylene catalysts to our portfolio. Feedback from customers has been quite positive. They are eager to see how we combine our new and existing catalyst technologies to create even better-performing products.

And our employees are excited too. Our commercial, technology, and manufacturing teams are on track with their integration activities and strongly focused on achieving the synergies in our acquisition model.

We paid $250 million for the business or 12.8 times trailing normalized EBITDA. With our expected cost and capital synergies, the multiple would be 8.8 times.

Synergies will begin to benefit earnings in 2017 and will be fully realized by the end of 2018. Tom will give you additional details on how to model the acquisition for the rest of 2016.

Turning to our business performance, Catalysts Technologies performed well in Q2 with very good margins. We saw the strong sequential improvement we expected, including a sequential improvement in FCC catalyst pricing.

Global demand for transportation fuels remains, strong with US gasoline demand at record levels. Offsetting this, however, is an increase in refined product inventories, which is leading some refiners to reduce production levels. This did not impact catalyst demand in Q2, but may impact demand in the second half.

As we look at the second half we're pleased to now be supplying the Takreer refinery. This is an important customer in an important region using one of our best catalysts.

As we approached the fall refining turnaround season, we're a bit more cautious on demand, given the increase in refined product inventories. Taken together, total sales volumes will still increase significantly over the first half, which will improve operating leverage and EBITDA margins for this business going forward.

We made good progress with our MTO catalysts in Q2. We now have a solid reference account in China and are marketing our technology to other customers there. Although small this year, MTO has the potential to become a significant growth opportunity for us.

In specialty catalysts, North America and European markets are stable, though China is showing some weakness. With the slowdown in growth there we're seeing a slowdown in production rates for some of our customers. This reduces catalyst consumption, delays catalyst orders, and has delayed some new licensing opportunities. As a result, we've reduced our expectations for specialty catalysts sales in China in the second half.

Despite these headwinds, our specialty catalysts business continues to grow. Our CONSISTA non-phthalate polypropylene catalysts are doing very well, providing customers the benefit of non- phthalate donor technology and the ability to make a wide range of higher-value, differentiated polymers.

Even in China, many customers continue to invest and grow. We successfully started up a new UNIPOL polypropylene plant in China in Q2, and we are seeing strong interest by existing Chinese customers to use CONSISTA catalysts to produce differentiated polymers at higher margins.

Our Materials Technologies business also performed well in Q2. We saw strong margins and a solid recovery in Q2 volumes following a weak Q1.

Demand in North America and Europe was in line with our expectations, and demand in Asia strengthened considerably, confirming our view that the weak Asia demand in Q1 was an inventory correction. In the second half, we expect stable silica sales and improved sales in pharmaceutical and nutraceutical intermediates.

With that I'll turn the call over to Tom.

Tom Blaser - *W.R. Grace & Co. - SVP, CFO*

Thank you, Hudson. Before we get into the financial performance, let me do a bit of housekeeping on four items that will help you understand our financial results and guidance.

First, you will recall that we filed an 8-K containing Grace's 2015 adjusted financials to account for GCP Applied Technologies on a discontinued operations basis. Our financial commentary throughout 2016 will compared to 2015 on that DiscOps basis.

As a guideline, the DiscOps presentation has about $9 million of additional corporate costs per quarter compared to our run rate for 2016. These costs were either assumed by GCP at the time of separation or have been eliminated through restructuring or other cost-reduction actions.

Second, last quarter we shared with you that we exited certain product lines in our Materials Technologies segment. You'll hear me make reference to normalizing for this in our analysis of results.

Third, earnings for the acquired polyolefin catalyst business are expected to be minimal in 2016 as a result of one-time deal and integration costs. For 2017, we expect a full-year impact to earnings with run rate synergies being reached by the end of 2018. You should note the D&A percentage to EBITDA on the acquisition is higher than our recent historical average by about 20 points.

And finally, in March 2016 the FASB issued a new standard which changes how Company's account for certain aspects of share-based payments to employees. Grace adopted this standard in Q2.

There is a $0.02 positive impact on EPS this quarter from the change and a $0.07 positive impact on the year-to-date basis. Because we can't predict future stock option exercises, we have not included any future impact of this change in our EPS guidance. Please consider these points in your analysis of our performance and guidance.

Now let's move to the numbers. Grace's second-quarter sales were $390 million, down 4% versus Q2 last year as-reported, and down 3% adjusting for product lines exited earlier in the year. However, compared to the first quarter, sales grew 9% sequentially excluding the exited product lines.

On an overall basis, our adjusted gross margins expanded to more than 44%, up 280 basis points compared to the prior-year quarter. Adjusted EBIT for the quarter was $96 million, up 17%. Adjusted EBIT margin was nearly 25%, up 440 basis points over Q2 last year.

Adjusted EPS for the quarter was $0.74 per diluted share, up 45% from last year. Adjusted free cash flow for the first half was nearly $133 million, which compares to $146 million a year ago and represents more than 50% of our full-year expectations.

Our adjusted EBIT return on invested capital on a trailing four-quarter basis was 22.7% as-reported, and 26.7% excluding the polyolefin catalyst acquisition completed at the end of June. This compares to 24.3% at the year-end 2015. ROIC will continue to improve as we lap the DiscOps effect and realize the earnings potential of the recent acquisition.

Looking to our business segments, starting with Catalysts Technologies, sales were down 4% versus last year and earnings grew 1%. Adjusted gross margin was up 290 basis points compared to last year, to more than 46%, reflecting combined productivity improvement and lower cost input partly offset by lower volume. On a sequential basis, sales volumes grew 6% and earnings were up 12%.

Moving to Materials Technologies, sales were down nearly 5% from the year-ago period and flat excluding the exited product lines. Earnings were up about 18% on lower manufacturing costs and productivity improvement. On a sequential basis, sales were up 10% and earnings were up 35%, reflecting volume leverage and stronger product mix.

As expected, after completing the polyolefin catalyst acquisition, our leverage ratio is approximately 2.8 times EBITDA, which is outside our target range of 2.0 to 2.5 times. As previously communicated, we intend to revert back to that range in 2017.

In the second quarter, we spent $20 million on a share repurchase, and total first-half repurchases were $35 million. Today, we announced our quarterly dividend, equal to $0.17 per share, with payment expected on September 14.

Let's review our 2016 outlook and then we can open the call for questions. We are tightening our full-year guidance for 2016 adjusted EBIT to be in the range of $400 million to $405 million; adjusted EBITDA in the range of $500 million to $505 million; and adjusted EPS to be in the range of $3.05 to $3.10 per share. These ranges represent strong double-digit growth over 2015 and assume an average exchange rate of $1.10 to the euro for the remainder of the year.

Heading into the second half, we have good momentum and credible line of sight to sequentially increasing sales and earnings. Specifically, in Catalysts Technologies, we anticipate improved sales volumes in FCC, growth of new product sales in licensing timing in specialty catalysts, and good visibility to increase demand in ART.

We expect Catalyst earnings to increase low to mid single digits for the year, reflecting a slower start for Takreer. This includes an expectation of minimal contribution from the polyolefin catalyst acquisition this year as we digest deal and integration related costs.

Turning to Materials Technologies, while we expect quarterly sales to continue at Q2 levels for the remainder of the year, we see improving margins through mix shift towards our fine chemical business and new product launches. After adjusting for the spin and exit of certain product lines, we expect double-digit earnings growth year-over-year in this segment.

In the second half, we expect sales and profit growth to accelerate sequentially. This will happen as we reach the full run rate of supply in Takreer, improve mix in Materials Technologies, integrate the polyolefin acquisition, and realize additional productivity benefits.

Regarding Q3, on a sequential basis we expect our earnings to grow low to mid single digits and adjusted EPS to increase similarly, excluding the effect of the standard adoption in Q2.

For full-year 2016, we continue to project corporate cost between $65 million and $70 million, and pension expense to be about $12 million. We expect interest expense for the full year to approximate $82 million.

We also continue to project capital investments for 2016 between $130 million and $140 million. This guidance range includes the capital required to achieve certain synergies from the polyolefin catalyst acquisition.

Our guidance remains unchanged for 2016 adjusted free cash flow to be at least $250 million including the favorable impact of our low cash tax rate.

In closing, we remain committed to our rigorous and disciplined approach to profit growth, cash generation, and capital allocation management through which we expect to continue to deliver increasing value to our shareholders. With that, we'll open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mike Sison, KeyBanc.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Good morning, guys. Nice quarter.

You had mentioned some customers wanting on the refining side to reduce production in the second half of the year. What was the impact for that in your guidance? Does that take away from the high end as you look into the second half of the year?

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

Yes, I mean -- you're talking the comment that we made on the FCC side of it?

Mike Sison - *KeyBanc Capital Markets - Analyst*

Yes.

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

Yes, we put a little bit of caution into the second half. We just want to be prudent, after having seen some of these high inventory levels.

But I don't think it's an overreaction. I think it's just being prudent.

When you look at what's changed, really, from the last time in April when we talked, we're going to have the Takreer for what we believe is one solid, solid quarter of volume on that side of it.

We did take down our specialty catalyst sales related to China fairly dramatic in the second half. We get those orders three to six months out, and that business has slowed. That's almost -- or it's more than $5 million of earnings.

The good news is those are all our licenses. The good news is they are just not running as hard, so that volume will come back.

But that's primarily it. We had a quarter of Takreer, we've taken out the China volume in the second half, a little more prudent on the FCC. That's about the change here.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Great. Then I think you noted that ART should look better in the second half of the year. Could you give us a little bit of color on why that should start to improve?

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

Yes. No -- this is Fred again. We've got good visibility. I'll tell you the hydrocracking business is strong on the orders side of it. Hydrocracking for diesel. We partner with Chevron Lummus on that side of it, and we've got very good visibility.

Going into the year I think we said it would be roughly flat. I think maybe by the end we may be up a little bit on that side of it, and feel good about going into 2017.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Great. Last one on FCC pricing. It was up sequentially. Do you see more momentum as you head into the second half of the year and into 2017?

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

Mike, this is Hudson. We do see another sequential improvement from Q2 to Q3. It will be small again; but we're continuing to focus on executing that strategy.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Great. Thank you.

Operator

Edlain Rodriguez, UBS.

Edlain Rodriguez - *UBS - Analyst*

Thank you. Good morning, guys. Quick question. Those inventories you talked about being high, how long do you expect that to continue? When do you expect customers to revert back?

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

Edlain, this is Hudson again. It really depends on the production decisions that our customers make. We've started to see some news over the last week or two that some customers are starting to reduce production rates in the second half.

It's certainly not true of every customer at this point. So it's a function of their production decisions.

This is a percentage point change; it's not a 5% or 10% type change. But on the size of this market, it can add up to be big numbers for our customers.

Edlain Rodriguez - *UBS - Analyst*

Clearly. Another quick one. Oil prices have been trending down recently. Do you see that as positive or negative for you? Or doesn't really matter that much to you?

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

Well, the demand for transportation fuels is clearly affected by the price of crude and, by extension, the price of gasoline and diesel. So the pattern that we've seen over the last -- I guess it's close to two years now -- lower crude prices, lower prices at the pump, higher demand for transportation fuel -- I think that sustains as long as crude prices are low. And that obviously translates into higher catalyst sales.

The mitigater on that is it puts pressure on our customers' P&Ls. Catalyst is a part of their production cost, obviously. They are looking at the efficacy of their catalysts.

That creates opportunities for us as well. So it's a balance, Edlain; it's a balance.

Edlain Rodriguez - *UBS - Analyst*

Yes, that makes sense. Thank you very much.

Operator

Laurence Alexander, Jefferies.

Dan Rizzo - *Jefferies LLC - Analyst*

Good morning. This is Dan Rizzo on for Laurence. You just said that catalysts are part of the production cost. Do you have roughly a percentage of that overall?

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

It's pennies per barrel. I'm drawing a blank on the exact percentage, but we talk about it as pennies per barrel.

Dan Rizzo - *Jefferies LLC - Analyst*

Okay, thanks. Then with Materials Technologies being somewhat stronger than we expected, what products are doing better than others? I guess, what's leading in that segment?

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

I'm sorry, in Catalysts Technologies?

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

No, no, in Materials.

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

Oh, in MT?

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

Yes. No, if you think about it, MT has got a broad range. Our coatings, our silica going into coatings has been very strong this year. On the negative side, our silica related to oil and gas and the final processing on that side has been weaker.

Consumer, that's a regional split. Consumer in Asia going into beer and so on has been down. Some of the architectural side has been up.

So we've got a really good materials position and it's geographically diverse and product diverse. What we're excited about going into the second half is you're going to see basically same amount of revenue but a better mix of business because of our fine chemical orders as well as nutraceutical orders in the second half. So we're encouraged by that.

Dan Rizzo - *Jefferies LLC - Analyst*

Okay. Then a final question, just with nutraceuticals in general, that can be somewhat lumpy, can't it? I mean you have a big order, then it's nothing for a while; am I thinking about that the right way?

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

Yes, you are. We'll have -- back end of the second half of the year will be substantially better than the first half.

Dan Rizzo - *Jefferies LLC - Analyst*

All right, thank you.

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

I'll add, if I may, it might be nothing with a single customer, but we have enough customers that the business -- it exhibits some lumpiness, but it's not as extreme as all-or-nothing for the whole portfolio.

Dan Rizzo - *Jefferies LLC - Analyst*

Got you. All right; thank you, guys.

Operator

Christopher Parkinson, Credit Suisse.

Christopher Parkinson - *Credit Suisse - Analyst*

Perfect; thank you very much. You just hit on this a little, but sticking to the Materials Technologies side, your commentary was a little mixed on a regional basis. Can you just hit on what you're specifically seeing in Asia, given your comment on APAC versus China?

Then also it appears LatAm was actually getting a little bit better. Just any color there based on end-market would be greatly appreciated. Thank you.

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

Christopher, this is Hudson. Specifically with Asia, we saw a significant inventory correction in Q1, as you may recall. January and February were incredibly weak for us in China.

As we went through March, we saw China getting much better. And we read that as a good demand indicator for Q2. And for us as we went through Q2, the China business, the Asia business performed pretty much in line with what we expected.

The biggest part of our business there is coatings. We do some chemical process, but the biggest part of our business there is coatings; a little bit of consumer as well.

Christopher Parkinson - *Credit Suisse - Analyst*

Perfect. You also mentioned annual release -- turning back to the FCC side -- you saw a little bit of accelerating volume growth throughout the quarter. Can you just give a little more color on some of the volume trends you're seeing in the back half, specifically excluding Takreer, just on a regional basis? That would be much appreciated. Thank you.

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

Sure. So ex-Takreer, what we're expecting is good continued demand for transportation fuels on a global basis. How that translates into catalyst demand will be a function of customer production decisions, as we said a few moments ago.

When I break that down by region, we expect demand to be good in North America. Demand has been better than we would have thought six or nine months ago in Europe; that's been consistently true for the last few quarters.

Demand for us in Asia has been okay. We see a little weakness there compared to last year, but nothing significant.

Christopher Parkinson - *Credit Suisse - Analyst*

That's great. Thank you.

Operator

Bob Koort, Goldman Sachs.

Bob Koort - *Goldman Sachs - Analyst*

Thanks; good morning. I was wondering if you guys could talk -- it's pretty apparent what's happening in crack spreads in North America, and understand your comments there. Is it similar in Europe and then the developing world?

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

It is, Bob; this is Hudson. We're seeing customers in Europe and the Middle East and Asia all experiencing compressed crack spreads.

Bob Koort - *Goldman Sachs - Analyst*

On your BASF comments of not contributing, am I reading it right that you're being fairly conservative and that's sort of a GAAP approach? Because it seems like, absent the one-off post-closing issues, you would have some accretion there. Is that correct?

Tom Blaser - *W.R. Grace & Co. - SVP, CFO*

No, Bob. It's Tom. I don't think we're being conservative. I think we've included -- unfortunately, the integration costs and the deal costs are substantial; we've only got a half year's worth of earnings; and as you know, we're increasing the utilization of that throughout the year. So we do have small earnings impact reflected in the second half.

Bob Koort - *Goldman Sachs - Analyst*

Can you give us some sense -- I know you mentioned ramping Takreer into the second half -- of where you see your overall FCC operating rates progressing through the rest of the year and into 2017?

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

Yes. Bob, it's Fred. I think we'll exit the year -- or I'm sorry, exit the third quarter around 90%. And I would expect us to exit the year in the mid-90%s, and that's a good rate for us going into 2017.

Bob Koort - *Goldman Sachs - Analyst*

And a last quick one if I might. Has there been anything around your customers in catalysts, their product mix and preferences, that would be causing much change in the slate that you offer to those customers? Or do you think we're in a pocket where you'll have some consistency in terms of the factors they are looking for in terms of product choice?

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

Yes. No, especially on the FCC side, I think the slates have stabilized. We're seeing that across our customers.

In the specialty catalyst side, on the positive, we're seeing a lot of customers really aggressively wanting our phthalate-free catalysts. We're sold out in that. And unfortunately, we've got a plant turnaround this third quarter to get a little bit more rate up, but that will come on very strong here in the next couple weeks.

And related to China, China is just the standard catalyst for our specialty side. That's just a matter of how hard they are running those units, and they aren't running them that hard.

Bob Koort - *Goldman Sachs - Analyst*

Got it. Thanks for the help.

Operator

(Operator Instructions) Chris Shaw, Monness, Crespi.

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

Yes, good morning, everyone. How are you doing? The MTO catalyst opportunity, I was wondering: is that something that you can get into existing plants that are already up and running in China? Or is it more reliant on the expected -- some of the new ones that are starting up?

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

Actually both. Actually both. Chris, we've got -- we're very pleased with the trials that occurred in the first alpha customer. He's allowed us to take those trials; they are in the marketplace now.

And in the short run we think that's a $250 million market opportunity, MTO catalysts. That's going to take a few years to develop, but we are well positioned. We have a MTO catalyst manufacturing operation on the ground in China, and it also integrates well with our polypropylene licenses in China as that sits on the back end of the plant. So we're optimistic about it.

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

I'm curious, though. The plants that are up and running there already that aren't using your technology, are they captive ones? Or does some competitor actually have a pretty big MTO product at this point?

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

No, they are actually Chinese-made, primarily Chinese-made catalysts. And it's just like on the FCC side: better technology gets better yields and better product out, and as you present these catalysts and run these catalysts through, we think technology wins in this space. Very akin to the FCC side of it.

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

All right, thanks. Then I might have missed it or -- sorry, but are you saying that buybacks are going to slow a bit here to shift over to debt repayment?

Tom Blaser - *W.R. Grace & Co. - SVP, CFO*

No; it's Tom. We're pretty comfortable with our programmatic approach we've been taking over the last couple quarters.

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

Okay. Great, thanks.

Operator

Jim Barrett, C.L. King & Associates.

Jim Barrett - *C.L. King & Associates - Analyst*

Good morning. Tom, a related question on the cash flow statement. Now that the BASF deal has been consummated and closed, and given your plan to leverage back into your target area in terms of debt, should we conclude from that that acquisition activity -- the visibility on that looking forward intermediate term is muted?

Tom Blaser - *W.R. Grace & Co. - SVP, CFO*

Well, first, from a business perspective, we've got a very active pipeline of acquisitions we're continuing to track and look at. From a cash flow perspective I think that we've got the firepower necessary to be able to execute transactions as we see fit.

Jim Barrett - *C.L. King & Associates - Analyst*

Okay. Then my second question was, could someone detail specifically the anticipated synergies from assimilating the BASF polyolefin catalyst business?

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

Jim, this is Hudson. They fall really into two categories. The first category is manufacturing cost reduction as we fold the new plants into our network.

And closely related to that is improved operating utilization of those assets. It's a combination of those two things that are driving 95% of the synergies.

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

Hudson, I'd make a comment on the commercial side. That's why your guys are excited around the polyethylene.

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

Good, good; that's a great point, Fred. Jim -- and for everybody -- we have not assumed any commercial synergies in this in our models. But the reality is there's a substantial opportunity there.

We're bringing together the existing Grace product technology both on the polyethylene side and the polypropylene side with some good technologies that we've acquired from BASF. I'll give a specific example: there is a LYNX polyethylene catalyst that's a Ziegler-Natta catalyst that fills a hole in our product pipeline -- excuse me, in our product portfolio. We're excited about that.

As we've gotten into this deeper over the last four or five weeks, we're seeing opportunities to learn from each other. We know how to do things in our labs, in our plants that the BASF team did not know how to do. And vice versa: they're teaching us some things about product performance and manufacturing operations that we didn't know. And this is exciting for us.

Jim Barrett - *C.L. King & Associates - Analyst*

Thank you very much.

Operator

Thank you, ladies and gentlemen. This now concludes our Q&A session. I'd like to turn the call back over to Tania Almond for closing remarks.

Tania Almond - *W.R. Grace & Co. - IR Officer*

Great. Thanks, Andrew. We just want to thank everyone on the call for joining us today. If you have any follow-up questions you can reach me at 410-531-4590. Thanks very much and have a great day.

Operator

Ladies and gentlemen, thank you again for your participation in today's conference. This now concludes the program. You may all disconnect at this time. Everyone have a great day.
