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GRA - Q3 2016 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 3Q16 sales of $404m and adjusted diluted EPS of $0.80. Expects 2016 adjusted EPS to be $3.05-3.10.

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

John Roberts *UBS - Analyst*

Christopher Parkinson *Credit Suisse - Analyst*

Mike Sison *KeyBanc Capital Markets - Analyst*

Dan Rizzo *Jefferies LLC - Analyst*

Robert Koort *Goldman Sachs - Analyst*

Michael Harrison *Seaport Global Securities - Analyst*

Ben Kallo *Robert W. Baird & Company, Inc. - Analyst*

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

Chris Kapsch *Aegis Capital - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the W.R. Grace & Co. third-quarter earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to Ms. Tania Almond, Grace's Investor Relations Officer. Ms. Almond, you may begin.

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

Thank you, Takia. Hello, everyone, and thank you for joining us today on October 26, 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 under the Securities Act and Section 21E of the Exchange Act.

Actual results may differ materially from those projected or implied, due to a variety of factors. Please see our recent SEC filings for more details about the risks that could impact Grace's future operating results and financial conditions.

We will discuss certain non-GAAP financial measures, which are described in more detail in this morning's 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 to the Q&A.

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

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

Thanks, Tonya, and good morning, and welcome to all of you for joining us. Grace had another good quarter. We continue to achieve good margin improvement and strong cash flow. We also saw the return of topline revenue growth both year-over-year and sequentially, and delivered $103 million of adjusted EBIT, or $0.80 per share.

Revenue and margins were strong in our catalyst business, but slightly lower than expected in materials. Our ART joint venture with Chevron was a bright spot with strong earnings in the quarter. We also made good progress with the integration of our polyolefin catalyst acquisition, along with solid productivity improvements. Both are on pace with our plans.

Regionally, there were no big surprises. North America was just a bit weaker than we thought, though stable. Europe was a little stronger than expected, and Asia remains weak, especially in China. For the rest of this year, we'll continue to focus on sequential sales growth, on integrating and leveraging the polyolefin catalyst acquisition, on our mix of productivity and operational excellence actions, and on delivering strong cash flow to fund more growth and return cash to shareholders.

We will provide our formal 2017 outlook when we report our full-year results next year, but as we're putting those plans together now, I can highlight some of the factors that are shaping our expectations.

We see tailwinds in several important areas. We expect volume in the FCC business to continue to grow. In addition, we see strong demand in our new polyolefin catalyst product offerings and are moving forward with our investment to support the growth. On the material side, our demand in the pharmaceutical and nutraceutical areas are strong exiting the year, and we do not expect the inventory correction in silica product lines we saw in the first quarter of this year, to repeat.

Finally, we continue to have significant productivity opportunities across the business. As for headwinds, we think we're about a year into what we expect to be about a 36-month downcycle in polypropylene licensing. In addition, demand for chemical catalysts in China is weak, and we don't expect this to turn around in the next 12 to 18 months.

There could be pockets of inflation and we'll watch that closely. Finally, this is all against the backdrop of a competitive low-growth global environment. All that said, we believe we're taking the right steps to be successful in this environment, and look forward to another year of earnings growth and strong cash flow to reinvest in our future and return cash to shareholders.

With that, I'll turn it over to Hudson.

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

Thank you, Fred. Catalyst technologies performed well in Q3, with good margins. Our refining catalyst business grew earnings double-digits, with good contributions from both our ART joint venture and our business in the Middle East. We see continued improvement in the SCC catalyst market.

Product performance has become more important than price as a driving factor in winning and retaining business. This is a healthy indicator for us, and supports our confidence that we can capture value through price and product reformulation as customers sign and renew with us over the coming years.

SEC catalyst pricing improved again in Q3 and is now up 0.8% from Q1. Global demand for transportation fuels remain strong, with gasoline demand up 1.7% year-over-year. Mitigating this, however, are high levels of refined product inventories, which affected Q3 refining margins and prompted some refiners to reduce crude runs or shipped product slates.

Several customers recently informed us of unplanned shutdowns during the final months of this year. As a result, we remain cautious on demand projections, particularly given the level of refined product inventories.

We remain on track integrating our polyolefin catalyst acquisition. Customer feedback has been quite positive, and it is clear the LYNX technology is a great addition to our portfolio. We acquired the business with a very strong hypothesis around manufacturing synergies and capacity utilization opportunities.

120 days in, the strong commercial fit, high-quality manufacturing operations, combined technical capabilities, and solid culture fit, all confirm our thesis. We feel very good about where we are, though we still have plenty of work to do over the coming years to maximize the return on this investment.

Specialty catalyst markets in North America and Europe are stable, but China continues showing weakness. Year-to-date, lower sales in China reduced Grace's overall sales growth by nearly 2 percentage points, with most of that in our specialty catalyst business. The biggest headwind is in chemical catalysts, especially the BDO and pyridine markets.

We also see continued weakness in the polypropylene licensing market. Although we recently won two new licenses, we continue to expect lower overall licensing revenue and earnings in 2016 and 2017. That said, there are strong positive signs in our specialty catalyst business. The one I'm most excited about is the demand for our high-performance CONSISTA non-phthalate polypropylene catalysts.

This technology enables our customers to make a wide range of higher-value, differentiated polymers, and earn higher margins in their business. We're seeing customers in every region move quickly to adopt this new technology.

Our ART joint venture had a very good quarter, and has good visibility for Q4. Recently, we've had some nice wins in ebullating bed technology, which helps improve the run rate volume of this business.

Materials Technologies grew in Q3, despite weakness in some regions and end markets. In North America, silica demand appears to be moderating after a strong first half, with a slowdown in the coatings market impacting our sales volumes. In EMEA, growth in coatings, consumer and industrial markets was partially offset by weak process adsorbents demand.

And in Latin America, improved conditions in Brazil contributed to good growth in the silica business. For Q4, we expect stronger sales and earnings in MT, with good performance in silicas and a strong year-end finish in fine chemicals.

We continue to improve margins with a strong emphasis on productivity. With a spinoff of GCP Applied Technologies, we significantly simplified our business, eliminating more than 50 manufacturing sites worldwide and creating an opportunity to focus even more on our manufacturing performance.

This year, we completed a comprehensive review of our fixed costs and are moving ahead with an increased focus on areas such as maintenance effectiveness, process capabilities, and capacity planning. This is all part of a multi-year effort to improve productivity in our already-good manufacturing operations.

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

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

Thank you, Hudson. Grace's third-quarter sales were $404 million, up 1% versus Q3 last year as reported, and down 1%, adjusting for acquisitions and product lines exited earlier in the year. Overall, Grace's adjusted gross margins expanded to nearly 43%, up 60 basis points compared to the prior-year quarter.

Adjusted EBIT for the quarter was $103 million, up 22%. Adjusted EBIT margin was over 25%, up 420 basis points over last year. Adjusted EPS for the quarter was $0.80 per diluted share, up 48% from last year, including a $0.02 positive impact from the stock option accounting change.

Adjusted free cash flow year-to-date was over $190 million, which compares to $212 million a year ago. This represents 76% of our target of at least $250 million for the full year. Our adjusted EBIT return on invested capital on a trailing four-quarter basis was 23.3% as reported. This compares to 24.3% at year-end 2015 and 22.7% last quarter. ROIC will continue to improve as we lap the disc ops effect and realize the earnings potential of the recent acquisition.

Looking at our business segments, starting with Catalysts Technologies, sales were up 4% versus last year and earnings grew 9%. Adjusted gross margin was up 110 basis points compared to last year to 45%, reflecting productivity improvements and lower-cost inputs, partly offset by mix effect related to the polyolefins acquisition.

On a sequential basis, total sales grew 6%, including the benefit from the recent acquisition, and earnings were up 8%. Materials Technologies sales were up 2%, excluding the exited product lines, and down 5% on a reported basis. Adjusted gross margin was 38% for the period. Earnings were up 12% from lower operating expenses, primarily driven by the cost takeout related to the exited product lines. On a sequential basis, sales were flat, excluding the exited product lines.

In the third quarter, we spent $20 million on share repurchase, and total year-to-date repurchases were $55 million. Today, we announced our quarterly dividend equal to $0.17 per share, with payment expected on December 8.

Let's review our 2016 outlook, and then we can open the call for questions. We are maintaining 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 euro exchange rate of [$1.10] for the year.

Looking at the fourth quarter, we continue to see credible evidence of sequentially increasing sales, earnings and cash flow. Specifically in catalysts, we see increased sales from our Middle East customer start-up; continued improvement in ART volumes, driven by our secure backlog; specialty catalysts order timing and licensing wins; and added contribution from our recent acquisition.

In Materials Technologies, we see slight revenue improvement and positive mix shift towards our higher-margin, fine chemicals business and products. Net-net for the year, we expect the Catalysts segment earnings to increase mid-single digits, and Materials Technologies segment earnings to increase high-single digits.

We continue to project 2016 corporate costs between $65 million and $70 million, and pension expense to be about $12 million. We expect interest expense for the full year to approximate $81 million.

Our capital investments for 2016 will approximate $120 million, down from our previous range of $130 million to $140 million. This level continues to include the capital required to achieve certain synergies from the polyolefins catalysts acquisition, as well as our continued focus on timing our investments to align with our customers' spend and the market.

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. This year, our cash taxes will be outside of our longer-term cash tax rate of 12% to 15% as we satisfy prior-year non-US tax obligations.

In closing, we remain committed to our disciplined approach to profit growth, cash generation and capital allocation management, as we continue to deliver increasing value to our shareholders.

With that, we'll open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Roberts, UBS.

John Roberts - *UBS - Analyst*

Could you help us understand how Takreer affected the sequential comps in the Catalysts segment third-quarter versus second, and how it will affect forth versus third?

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

John, this is Hudson. We are -- we began supplying Takreer in Q3, as you know. We did not reach our potential with them in Q3. And so there was growth in Q2 to Q3 sequentially as that business ramped up, and there will be growth again from Q3 to Q4 sequentially as we approach the full -- a full run rates with that customer.

John Roberts - *UBS - Analyst*

Okay. You don't want to quantify that for us, do you?

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

No.

John Roberts - *UBS - Analyst*

Okay. And then just to help me understand -- when you see lower BDO catalyst demand in China, for example, is that the customer volumes of BDO are down? Or are they delaying maintenance on BDO units, and so it's a refill order that's missed? Or how does that lower demand to you kind of occur? What's the driver behind that?

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

It's a good question. So, their business is actually okay from a volume perspective. Demand for the underlying material is okay, but there's significant overcapacity in the industry, so they're running at low utilization rates, which means less requirement for catalysts. There's really not an opportunity for the catalysts to make a big difference in their units. And so -- because of those low utilization rates. And so they are pushing out maintenance activities; they're pushing out catalyst refills.

John Roberts - *UBS - Analyst*

Okay. And then just letting the activity run down on that catalyst longer than normal?

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

And when you're running at high utilizations, you care a lot about that. When you are at low utilizations, it doesn't really affect your economics.

John Roberts - *UBS - Analyst*

Got it. Thank you.

Operator

Christopher Parkinson, Credit Suisse.

Christopher Parkinson - *Credit Suisse - Analyst*

Can you just talk a little more about the headwinds you are facing that you include in your presentation, including the polypropylene licensing? And just anything else -- you mentioned the BDO, but anything else that's driving the weaker-than-expected catalyst demand? Just any color on these on the degree of how it's affected 2016 and your preliminary expectations for 2017, given current trends, would be great. Thank you.

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

Yes. You know, Chris, as we look out and as we're planning for 2017, first of all, we're planning our cost basis on a conservative level. We want to make sure, from a cost standpoint, we're conservative on that side of it. As we've gone through the year, we've seen the chemical catalyst volume continue to drop, as previously -- as Hudson mentioned with John -- based on the refill activity. So we're planning that to be low next year from that perspective.

On the licensing side, licensing is a cycle. You get a license, it takes about three years. On average, over the past years, we've won a little over three licenses. We've won two this year -- they happen to be backend-loaded. They just -- they've come in the quarter, which is a good sign from that standpoint. But we're planning conservative for next year.

And, at this point in time, I couldn't even tell you if we got one in the plan. But we want to plan conservative. You know, net-net, if you look at that whole effect going into 2017, it's probably $10 million of EBIT dollars, maybe $12 million of EBIT dollars. And we'll see.

But as I said -- when I look at 2017, I like what we're seeing on the FCC side of it. I like the specialty catalyst volume and the uptake on that position. We're going to plan conservatively on the cost.

Christopher Parkinson - *Credit Suisse - Analyst*

That's great color. Thank you. And you also mentioned positive -- some positive commentary on the pricing front going forward. And we saw a little sequential improvement there. But can you comment on what you're seeing, given the sluggish macro, just kind of going forward? I mean, is the opportunity to drive price mix, mostly mix? And then just any comment on how large the reformulation opportunities are, would be greatly appreciated. Thanks.

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

Sure, Chris. This is Hudson. Great question. So, we -- when we look at account wins -- or losses, for that matter -- we analyze what happened -- what worked, what didn't work. And we've seen a significant shift in the drivers of account wins over the past year. Where price had been an important component of that a year or two ago, we're now seeing product technology be the driver in terms of customer decisions on suppliers.

That is a great development. And we think it builds or firms up the foundation that we've been putting in place, to create opportunities, to create more value through price and reformulation going forward.

What's the mix between price and reformulation? Traditionally, it's actually been more about reformulation. To some extent, it's a false distinction. Because even when we're driving price, it's really driven on the back of a new product technology that we're introducing. And so, to some extent, that's a false distinction. Price shows up more strongly in the top line; reformulations shows up more strongly in the gross margin line; but at the end of the day, we're creating more gross margin dollars either way, which is really what we're focused on.

Customers continue to come to us looking for technology solutions to their operating issues. And some of our customers have been reporting earnings over the last week or two. Most of them are seeing a tougher margin environment. That's an opportunity for them to come to us and say, how can you help us run our operations better? How can you help us get more value out of our refinery?

And that's what drives this virtuous cycle of different catalyst technology that's providing more value for our customer and our chance to capture a piece of that. That's the marketplace dynamic that's happening right now.

Christopher Parkinson - *Credit Suisse - Analyst*

Fantastic color. Thank you.

Operator

Mike Sison, KeyBanc.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Hi, guys -- nice quarter there.

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

Morning, Mike.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Fred, when you talked about volume growth in SCC in 2017, can you maybe help us out in terms of how much of that will come from Takreer? And then are you going to see some base -- sort of base SCC volume growth as well?

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

Yes -- listen, I don't want to get into too much of the specifics now. We'll give you all that color when we report for the full year. But obviously, we'll have a full year of Takreer, where basically, we've got four months, maybe four-and-a-half months this year. And we've got some -- and some of the other activity in some of the other regions has been positive, as we've gone through.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Great. And then in terms of industry operating rates for SCC, I think you're fairly close to running full out there. When you look across the landscape, is it fairly tight as you head into 2017?

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

Yes. we -- I mean, we think so. We can see ours. And, as you said, I think we're going to exit the year very tight from that standpoint. And the first quarter sometimes is not fully indicative because a number of customers take the turnarounds in the first quarter, as you know, from changing over from the heating season and so on, from that side of it. But everything we're seeing out there, the market continues to tighten up from a capacity utilization for our -- for the suppliers of catalysts.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Great. Thank you.

Operator

Laurence Alexander, Jefferies.

Dan Rizzo - *Jefferies LLC - Analyst*

It's Dan Rizzo on for Laurence. You talked about your productivity efforts in eliminating, I think, 50 manufacturing sites. I was just wondering, like, where we are in the process, how long it will take to kind of fully implement the efforts? Is it -- I mean, is it going to take over the next couple of years? Or is the bulk of it going to be done in the first six months or next six months or so?

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

You know, we've -- we constantly work productivity. I think you see it in our margins. And we've been able to expand our margins without a lot of volume uplift even this year. So that's something we work all the time.

Hudson has laid out a very good plan with all of the operations. And coupled with what Tom is looking at across all of our base costs, we're putting those actions together. It's really a 24 -- we wanted to get it implemented over a 24-month period starting next year. And I think we'll give you some color into that -- how much we expect in next year as we roll out our earnings guidance.

Dan Rizzo - *Jefferies LLC - Analyst*

Okay. And then you talked about reformulation as an important part of price. I mean, without the reformulation, is it very difficult to get price through? I mean, is there pushback on that, that you have to show them something before they will even talk about potentially just giving you some -- accepting some price increases?

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

The driver for the SCC catalyst industry -- actually all of the catalyst businesses -- is value-creation for our customer. And that means bringing them better technology. And that has always been the best lever for us on pricing. And whether it's a new account where we're bringing them a better technology, or an existing account where we're giving them something new based on some change in their circumstance, that's always been the winning driver for that business.

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

Let me just -- Tonya just shot me a quick note here. Let me just make sure we quantify -- or not quantify, make sure of the question. We're not eliminating 50 sites. What Hudson mentioned is where we had a broad range in GCP, we're focused down to now less sites on that side of it, and we're able to accelerate that productivity. So it's not the elimination of 50 sites.

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

These are GCP sites that went with the spin-off company.

Dan Rizzo - *Jefferies LLC - Analyst*

Oh, okay. (multiple speakers) No, it's fine. Thanks for the clarification and thanks for the color.

Operator

Robert Koort, Goldman Sachs.

Robert Koort - *Goldman Sachs - Analyst*

I wanted to explore something -- I'm a little bit surprised that -- Hudson, I think you said that the value proposition is starting to gain more traction with customers in the last year. And I guess I would have expected -- refining margins are down from where they were in their heyday, but they've been pretty stagnant over the last couple of years.

Is there something different about crude slates, about product slates? What flipped that switch? Because I think, as you said, the selling proposition has always been value enhancement for the customers. Why are they finally starting to respond to that in the last year?

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

I don't -- I wouldn't characterize it that way. I think the point I wanted to make is, that's an ever-present part of our business model is in the value-creation model we have with our customers. What had happened, if we go back a couple years, is price competitiveness had kind of -- had become a bigger part of it, and that's starting to fade away, getting us back to what has traditionally been the basis of competition.

Robert Koort - *Goldman Sachs - Analyst*

Got it. And would you say any thrifting or trade-down, then that is also behind the industry?

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

It depends. That's a customer-by-customer question. And we do have a portion of our customers that are focused on minimizing catalyst costs, and they'll trade that against refining performance. But most of our customers are focused on the other end of that balance, and they're willing to pay for the best catalyst technology to get the best operating performance in their refiners -- in their refineries.

Robert Koort - *Goldman Sachs - Analyst*

And if I can sneak one last one in. Can you give us a sense -- is there much ahead on the regulatory front that will stimulate demand, any more thresholds across some of your customers' customers that are going to need more active catalysts or different product?

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

There I don't -- I can't quote you the specifics, Bob, but the regulations in the emerging countries continue to tighten up towards mostly European standards. I'm sorry I'm drawing a blank on the degree and the timing for that.

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

Yes, let me jump in. I would say you'll see that more reflected in two areas -- one in the hydroprocessing side for low sulfur into diesel, and we're seeing good demand in our joint venture on the ART side from that perspective. So, that's a positive.

And the other side is still the need for propylene. I mean, propylene is still short. Look in China -- China is still importing propylene. And our two new licenses were for propylene on that side of it. So that continues to be favorable from a catalyst perspective.

Robert Koort - *Goldman Sachs - Analyst*

Great. Thanks, guys.

Operator

Michael Harrison, Seaport Global Securities.

Michael Harrison - *Seaport Global Securities - Analyst*

You had expected to have some integration costs related to the BASF acquisition during Q3. Can you quantify how much those costs were during the quarter? And do you expect any additional costs to stretch into Q4?

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

Yes, we don't typically provide that kind of detail, but I can tell you that most of those costs will be through the pipe -- that are through the pipe, through the third quarter. So we should expect uptick in the business from that.

Michael Harrison - *Seaport Global Securities - Analyst*

All right. And then I was also hoping that you could give some thoughts on the UOP dissolution of the relationship with Albemarle? Wondering if this is a threat or an opportunity as it potentially creates another player in the HPC market?

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

Yes, I mean, UOP -- it's Fred -- UOP has traditionally been in the licensing side and they partnered with Albemarle to supply the catalysts for the hydrocracking side that they had licensed. Albemarle has chosen to make that catalyst inside, from what we've seen in the public data -- I'm sorry --

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

UOP.

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

UOP -- I'm sorry about that -- has chosen to make it inside. I mean, what we've seen in the public data based on capacity, it's 1% to 2% of the industry capacity. We've got a very strong license partnership with Chevron Lummus and we've been producing that catalyst.

So we haven't seen a lot of dynamic shifts in the industry as a result of this. And it's good business. It's a good business out there, and it will continue to be a good business, and supported a lot by the lower sulfur regulations.

Michael Harrison - *Seaport Global Securities - Analyst*

All right. And finally, I was hoping that you could give a little more detail on -- you mentioned the refined product inventories being at relatively elevated levels. It does seem like refiners are working to manage them, whether that means doing some turnarounds or shutdowns or shifting some of their production away from gasoline toward distillates.

Can you just walk through the impact that you are expecting to see over the next couple quarters as those inventory levels spur refiners to take action? What does that exactly mean for FCC and hydroprocessing catalyst demand?

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

We think these are fine-tuning type adjustments when you think about it at the global level. Individual refiners may slow down or shift their slate or do an economic -- a turnaround for economic reasons, as you illustrated. But when you look at that across the global industry, we think these are pretty small fine-tuning type effects.

Michael Harrison - *Seaport Global Securities - Analyst*

All right. Thanks very much.

Operator

Ben Kallo, Baird.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

Hudson, on the reformulation question again, can you judge if you guys are gaining ground on technology? I guess that's most likely through share we judge that. But just kind of -- if you have any commentary on where you guys stand on technology advancements since I guess (technical difficulty) the price? And then maybe we can get some commentary on if anything has changed with the capital allocation or how we should think about that going forward? Thank you, guys.

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

Ben, we feel great about the quality of our technology portfolio. And it's something that we work on continuously. It is the biggest driver of the margin expansion we've had in Catalysts over the last many years.

And we're not the best supplier in every single situation. We have a lot of respect for our competitors' capabilities, but I would trade our -- I would not trade our portfolio for anybody's, and feel terrific about its strength and breadth, really.

On the capital allocation, I'll shift it to Tom.

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

Sure. So, Ben, thanks for the question. Our capital allocation remains consistent with what we've previously communicated. We see our priorities as capital allocations for growth, investment in R&D for new technology. And then we look at keeping our debt leveraged to a level we are comfortable with, and then we also look to return capital to our shareholders in the form of dividends and in share buyback.

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

Yes, I would jump in, Ben -- it's Fred. I mean, I don't -- we don't see any structural change to what you're looking at. And from an M&A pipeline perspective, we're looking hard and we'll see what we can do there. But at the end of the day, we generate a lot of cash, as you know, and we'll deploy that cash in that manner.

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

Next question, operator?

Operator

Chris Shaw, Monness Crespi.

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

Trying to read through maybe the -- between the lines a little bit on your views on SCC pricing going forward maybe longer-term through 2017. It might sound like you're a little more cautious in terms of demand, so that might impact your view slightly through next year, but at the same time, I guess you're more positive on the uptake in technology. So, I mean, net-net, are your views still the same in terms of your ability to get the price increases?

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

I think the simple answer is yes, Chris. I wouldn't try to split hairs or find the nuance. What we're trying to communicate is we feel very good about our technology. We feel good about our ability to bring solutions to our customers that they value and will pay for.

And the differences between price and reformulation are irrelevant when you get to the gross margin line. And I don't mean that to be backing off on prices; it's that these are nuances that are really too fine for how the business works.

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

Right. Okay, thanks. And then the Catalysts segment, the gross margins in the quarter were down. And I assume that's some impact from BASF, and is it also an impact from the Takreer volumes at all? Or what's in there exactly?

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

No, it's like you said -- it's really related to the weaker margins coming from the BASF acquisition.

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

And have you indicated either qualitatively or else sort of what the differential in the BASF margins were relative to the Catalysts segment margins in basic terms?

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

Yes, we haven't. What we have shared is what we thought the trailing 12-month EBITDA range was for the business as we made the acquisition.

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

Oh, that's right. Thanks. And then just finally, do you anticipate buybacks accelerating any time soon, now that you've gotten the balance sheet more in order?

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

So it's a great question -- you know I can't answer that, but what I can tell you is that under our current authorized share buyback, we've got about $170 million left at the end of Q3.

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

All right. Fair enough. Thanks, guys.

Operator

Chris Kapsch, Aegis Capital.

Chris Kapsch - *Aegis Capital - Analyst*

I just had a couple follow-up questions on the current trends primarily in Catalysts business. And specifically on the nuance about the refined product slates and the excess inventories, and the consequent refinery cuts. Was that commentary focused on the domestic refining end market? Or if you could just provide some color on how that's playing out on a global basis by region?

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

Chris, we meant it to be -- this is Hudson -- we meant it to be global. Obviously, where inventory levels are, vary around the world. There are high refined product inventory levels in the United States, but this is a truly global market. And a lot of the outlet for that inventory is exports. So, I think the regional distinctions are -- don't really have effects on our business.

Chris Kapsch - *Aegis Capital - Analyst*

I was just wondering if the refinery cuts that you cited were more acute, say, domestically vis-a-vis some of the other regions?

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

Sorry, I may have misunderstood your question. No, there's no regional concentration to the unplanned shutdowns. We're seeing them in three out of the four regions that we operate in.

Chris Kapsch - *Aegis Capital - Analyst*

Okay. Thanks. And then you mentioned, on a forward look, a lot of cross-currents; encouraging outlook in FCCs and polyolefin catalysts, and maybe less sanguine in chemical cats and polypropylenes. Could you just now talk about HPC -- and I know that flows, I guess, through ART -- could you just talk about the -- because one of your competitors -- or one of the competitors in that space talked about the order backlog seemed pretty strong. So, curious how that's looking out into 2017? Thanks.

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

We have a good backlog in our ART business right now. It's -- we've got strong order backlog for Q4. ART has had a good year this year, and we think it will have a good year next year.

Chris Kapsch - *Aegis Capital - Analyst*

Okay. Thank you.

Operator

Thank you. And I'm showing no further questions in the queue at this time. I'd like to turn the conference back over to Ms. Tania Almond for closing remarks.

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

Yes. No -- this is Fred. I'm just going to wrap up real quickly. When we last talked to you on the second quarter, and now we're talking to you on the third quarter, fundamentally, nothing has dramatically changed. The puts and takes in the third quarter, you know, we got there a little bit differently, a little bit weaker on the chemical catalyst side, a little bit weaker on adsorbents, stronger on our polyolefin specialty catalyst in ART.

And going out forward for the fourth quarter, we see good volumes on the FCC side of it. We see a slight uptick in ART. We're confident on the specialty catalysts, especially the new products delivery, and we've got a good mix of business going into the fourth quarter with our Materials business.

So, again, nothing's dramatically changed; a little bit different mix. And we look forward to updating you on 2017 as we report our fourth quarter. So, thank you.

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

Thank you very much. And if you have any follow-up questions, you can reach me at 410-531-4590. Thank you very much and have a great day.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may now disconnect. Everyone have a great day.
