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GRA - Q3 2015 W. R. Grace & Co Earnings Call

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OVERVIEW:

Co. reported 3Q15 sales of $790m and adjusted diluted EPS of $1.37. Expects 2015 adjusted EPS on constant currency basis to be $5.25-5.35.

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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. - SVP and CFO*

Greg Poling *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

CONFERENCE CALL PARTICIPANTS

Brian Maguire *Goldman Sachs - Analyst*

Mike Ritzenthaler *Piper Jaffray - Analyst*

Mike Sison *KeyBanc Capital Markets - Analyst*

Jim Barrett *CL King and Associates - Analyst*

John McNulty *Credit Suisse - Analyst*

John Roberts *UBS - Analyst*

Laurence Alexander *Jefferies LLC - Analyst*

Edlain Rodriguez *UBS - Analyst*

Tyler Frank *Robert W. Baird & Company, Inc. - Analyst*

Chris Kapsch *BB&T Capital Markets - Analyst*

Matt Schnabel *Wells Fargo - Analyst*

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

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the W. R. Grace quarter-three 2015 earnings conference call. At this time all participants are in a listen-only mode. (Operator Instructions) As a reminder this conference call is being recorded. I would now like to turn the conference over to Tania Almond, W.R. Grace Investor Relations Officer. Please go ahead.

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

Thank you, Abigail. Hello, everyone, and thank you for joining us today on October 22, 2015. With me on the call are Fred Festa, Grace's Chairman and Chief Executive Officer; Greg Poling, our Chief Operating Officer and the future CEO of GCP Applied Technologies; and Hudson La Force, our Chief Financial Officer. Our earnings release and corresponding presentation are available on our website. To download copies, go to grace.com and click on investors.

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 details 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. Reconciliation to the most directly comparable GAAP financial measures and other associated disclosures are contained in our earnings release and our website. Our comments on forward-looking statements and non-GAAP financial measures apply both to the prepared remarks and to the Q&A.

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

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

Great. Good morning, and thanks, Tania. We had a good quarter, with strong execution across the enterprise. Earnings and cash flow exceeded our expectations for the quarter, and we are on track to achieve our earnings and cash flow outlook for 2015. We are focused on productivity, capturing raw materials deflation, and driving growth in products and regions where the opportunities exist.

Grace is positioned to manage uneven growth around the globe through our uniquely positioned manufacturing assets, strong technology, and product portfolio, and good geographic diversity. In the third quarter many of our regions saw good growth.

Overall, emerging region volume growth was positive, led by growth in the Middle East and Asia, excluding China. China was down mid-single-digits, but represents only 5% of our total sales. All three segments improved margins, and adjusted EBIT was up slightly at constant currency, despite overall lower sales volumes. Adjusted EBIT return on invested capital increased to over 32%, reflecting the high quality and value of our businesses.

Hudson will give you the details on Venezuela, but let me net it out for you. Before the effects of increased inflation in Venezuela, Grace's third-quarter earnings were about $5 million better than our expectations due to better gross margins and lower operating expenses. We have been working very hard to serve our customers in Venezuela and anticipated the higher sales volume -- but did not anticipate the significant increase in inflation that began in September.

Let's turn to the businesses. In catalysts, we beat our third-quarter earnings goal and continued making progress in positioning our refining catalyst business for the future. We are strengthening our commercial positions in North America, the Middle East, and Asia, and building a solid foundation for the capacity investments planned for this business. The refining and petrochemical end markets we supply are healthy. Demand for transportation fuels and plastics is good, and utilization rates are good for our customers.

From industry perspective, six new FCC units have started up this year, with another two expected to start up by year-end. In the US, miles driven were up 4% year on year in July, with gasoline demand up 3% year on year. In the fourth quarter, we expect catalyst earnings to be up double-digits sequentially, assuming the refining turnarounds and customer changeovers remain on schedule.

In materials technologies, we also beat our Q3 earnings goal, though sales were slightly lower than we wanted. Sales volumes decreased in North America and Asia and increased in Europe and the Middle East. In engineered materials, our plastics end markets were strong, and coatings end markets were stable. Darex continues to work through the shift from three-piece cans to two-piece cans while demand continues to grow for our non-BPA technologies. We exited the third quarter in engineered materials stronger than we entered it.

Construction products had good overall volume growth and very good margin expansion in the quarter. Sales volumes grew 5% in North America and double digits in the Middle East and emerging Asia, excluding China. We had negative sales volume growth in China and Brazil, reflecting weaker demand conditions in those markets.

The product and regional diversity of our construction portfolio allows us to mitigate the effects of regional slowdowns. We continue to introduce new products and take advantage of growth markets. Across both Grace and GCP, some regions are performing better than others. During these times, we are focused on securing our market positions, introducing new products, staying nimble, simplifying our operations, and managing our capital.

I am pleased that we continue to achieve our earnings and cash flow goals in this environment. We are on track with our 2015 business goals and are well positioned for further growth in 2016. I feel good about the progress we're making positioning Grace for the future.

We have demonstrated that we can execute well in a tough global environment, leveraging our technology, disciplined productivity focus, and global portfolio. We will exit 2015 with lean cost structures, new strategic wins, and portfolios positioned to grow in both Grace and GCP. We are both excited about the year ahead. I will turn the call now over to Greg to provide an update on the separation, and then Hudson will review the quarter in more detail and outlook.

Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

Thanks, Fred. During the third quarter we made good progress towards standing up GCP Applied Technologies as an independent Company. In August we filed GCP's initial Form 10 registration statement with the SEC, and in September we filed the first amendment, adding the Q2 carveout financials and responding to the SEC comments on the first filing. We expect to file our second amendment, including the pro forma financial statements, in the next few weeks.

We've also made good progress building the GCP senior management team and selecting our future Board of Directors. We named our CFO, Dean Freeman, in September; and our VP of Strategy and Corporate Development, Naren Srinivasan, earlier this week. The rest of the leadership team and our Board of Directors will be announced later this year.

Operationally, we have worked through a rigorous process to reengineer the future state organizational structures and processes for each Company. This work sets up both Companies for success after the separation. We have optimized the cost structures of both GCP and Grace and expect to reduce the costs within both companies by enough to offset the added stand-alone cost of GCP.

Of course, that will not be the case on day one, but we do expect to achieve that cost goal within 12 to 18 months of separation. We still have many things to complete before the separation, but we remain on track to spin in the first quarter of 2016.

I am very excited about the opportunities we have before us, and I look forward to seeing you during our roadshow early next year. With that, I'll turn the call over to Hudson.

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

Thank you, Greg. Grace's third-quarter sales were $790 million, down 8% as reported, and down 1% at constant currency. Currency reduced sales by $55 million, or about 6%. Adjusted EBIT was $173 million, down 4% as reported, and up slightly at constant currency. Currency reduced earnings by about $8 million or 5%.

Adjusted EPS was $1.37 per diluted share, up 28% and up 36% at constant currency. Adjusted free cash flow was up 2% to $343 million. On Venezuela, most of you know that we have had declining sales volumes in our Venezuelan subsidiary due to currency and import controls that have limited our ability to import raw materials into the country. After many months of effort, we were able to import a significant amount of raw materials into Venezuela in Q3. Our products go into construction and food packaging -- two important sectors -- and we're glad that we were able to catch up on past customer demand and supply some future demand as well.

Until September 30, we accounted for the results of our Venezuelan subsidiary at the official exchange rate of VEF6.3 bolivars per $1, but it is no longer appropriate to do so. Although we had significant success importing raw materials at the official exchange rate in Q3, we may not be able to do so in the future.

Effective September 30, we will account for the results of our Venezuelan subsidiary at the SIMADI rate. We recorded a charge of $72 million to reflect this change. From October 1, our Venezuelan subsidiary will be immaterial. This has no significant effect on our 2015 outlook, as the increased in earnings in Q3 are roughly equal to the reduction of earnings in Q4 from the devaluation.

We also want to be transparent about the effect of this change on future earnings. As you build your new GCP earnings models, you should exclude Venezuelan sales and earnings from your forecasts. The sales and earnings details for 2014 and 2015 are in this morning's release and PowerPoint. For 2014 our earnings were about $20 million, and for 2015 they are about $31 million.

During this time, about 70% of Venezuela's sales were in SCC, the specialty construction chemicals business; and about 30% were in Darex. In Q3 itself, this ratio was about 80% SCC, 20% Darex.

Let's turn to catalyst technologies on page 7 of our presentation. Catalyst technologies gross margins were up 90 basis points compared to last year and 10 basis points from Q2. Our plants are running well, delivering good productivity and lower manufacturing costs. We took advantage of lower Q3 volumes to perform additional maintenance in our Curtis Bay facility. The improvements we made will further improve productivity, so the costs of the shutdown will reduce Q4 margins some.

We made good progress strengthening our commercial positions in FCC catalysts in North America, the Middle East, and Asia. And in specialty catalysts we saw double-digit growth in catalyst volume in Asia, resulting from new polypropylene process licenses sold in recent years.

Let's move to materials technologies on page 8. Materials technologies has seen significant headwinds this year from the stronger dollar and reduced demand in Europe and the emerging regions. Nevertheless, gross margins increased to 37%, excluding Venezuela, on lower manufacturing costs and improved pricing. Cash flow performance continues to be good, increasing 2% year to date despite 8% lower earnings.

We saw some bright spots in Q3. Europe grew for the first time in several quarters, and the Middle East grew double digits. We did see a slowdown in Asia, with signs of some inventory correction mid-quarter.

Please turn to page 9 for construction products. GCP had good sales volume growth of 5% in specialty construction chemicals and 4% in specialty building materials. Sales were up 5% in North America and double digits in the Middle East and emerging Asia, excluding China.

For earnings, let me give you the numbers with Venezuela excluded for 2015 and 2014. Gross margins excluding Venezuela increased 240 basis points to about 39%. And earnings excluding Venezuela grew 20% on a constant currency basis.

Net debt at the end of the third quarter was $1.9 billion and net debt to adjusted EBITDA leverage was 2.5 times. Our adjusted EBIT return on invested capital was 32% compared with 30% a year ago, up 260 basis points, driven by earnings growth and good working capital management. Let's touch on our outlook, and then we will open the call for your questions.

We are raising our 2015 outlook for adjusted EPS to $5.25 to $5.35 per share on a constant currency basis, up $0.10 from our previous range of $5.15 to $5.25 per share. We expect adjusted EPS to grow 19% to 21% this year on a constant currency basis. We continue to expect adjusted EBIT to be $675 million to $685 million on a constant currency basis, an increase of 8% to 9%.

We estimate the currency headwind to adjusted EBIT to be about $60 million and to adjusted EPS to be about $0.55 per share. While the euro has strengthened recently, it is offset by weakness in emerging region currencies.

By segment, we continue to expect catalysts to have a good fourth quarter in FCC, specialty catalysts, and ART. We expect sales volumes to grow mid- to high single-digits from Q3 and low single digits from last year's strong Q4. Gross margins will be below Q3 levels, reflecting the planned reduction in FCC catalyst inventory and the flow through of Q3 maintenance costs to Curtis Bay. We expect Q4 gross margins to be in line with year-to-date margins.

Higher sales and inflation and Venezuela affected Q3 gross margins in materials technologies and construction products. For Q4 we expect gross margins for those two segments to be comparable to Q2 levels. We continue to expect adjusted free cash flow to be at least $430 million for the year.

As most of you know, Grace has a low cash tax rate due to our NOLs. This year our cash tax rate will be about 15% compared with a 34% book tax rate. For the full year, this difference adds about $95 million to free cash flow. On a per-share basis, this is about $1.30, which would add roughly 25% to our adjusted EPS outlook. Looking at cash flow from another perspective, at current market prices our free cash flow yield is about 6%.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Brian Maguire, Goldman Sachs.

Brian Maguire - *Goldman Sachs - Analyst*

Hudson, if I did the math right, I think -- just to close the loop on the Venezuela issue -- it seems like if you were to build a bridge from 2015 to 2016 on EPS, you have about a $0.25 bad guy for Venezuela next year? Is that about right?

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

I have not done it on an EPS basis, Brian, but per share it is about $0.01 per dollar (sic). Let me give you -- or excuse me, per $1 million. Let me just give you kind of how we think about it. For 2014, I want to give some perspective. I know everybody is trying to build their GCP models.

For 2014, we had about $20 million of earnings in Venezuela. For 2015 we planned about $31 million. And that is about what we have year-to-date. Obviously, some of that shifted from Q4 to Q3, but we had expected that $31 million. That will go to zero as we head into 2016 with the devaluation.

Brian Maguire - *Goldman Sachs - Analyst*

And if the outlook going forward is basically immaterial to earnings, I guess it begs the question why you even continue to be doing business in that country. Is there any hope for things getting better or any reasons why you need to continue to operate down there?

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

Yes, Brian, this is Fred. Listen, our products are needed down there. We will continue to operate. We've got assets down there for both products. And we will be able to operate and continue to do business, but at the SIMADI rate. So in essence, we are making profit down there; but when it gets translated back at the SIMADI rate to US dollars, it is immaterial from that perspective. We will see where the change takes us going forward.

Brian Maguire - *Goldman Sachs - Analyst*

Okay. Just if I could shift to the FCC business, Fred, just curious how your conversations with folks out in the industry have gone since you had some business in the last quarter. It seems like you are in a sold-out position. Just wondering how customers are kind of reacting to that, either positively or negatively? And what is kind of the outlook for pricing in the industry going forward now?

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

Yes, you know, look, just to make sure we are crystal clear, if you look at our third quarter, similar to our second quarter, we were about flat. We are under -- just under the 90% utilization for us. We believe we will be moving that up in the fourth quarter, and then we will be at basically full utilization as we get into 2016.

As I said before, I think 2015 has been a year of the transition on FCC, from -- you've got large unit coming up. You have got refineries running very hard. You've got refineries trying to get their slates of crude lined out, and so on. I think stability is coming back to the industry. And I think that stability will pay -- will be good for the FCC suppliers from a number of aspects.

We've been able to get price in FCC based on our ability to show a refiner a new product, demonstrate those results, test those results, and then ultimately share the benefit of those results through our pricing and their benefit. I think as this year has settled down, 2016 is going to be the year that we are going to see more of that.

Brian Maguire - *Goldman Sachs - Analyst*

Great, thanks very much.

Operator

Mike Ritzenthaler, Piper Jaffray.

Mike Ritzenthaler - *Piper Jaffray - Analyst*

On the strategic commercial shift within FCC, I don't intend for this question to be too sensitive for this forum, but is this an initiative a matter of just emphasizing certain products or geographies? And is the expectation for the double-digit EBIT growth in Q4 sequentially sort of the beginning of the effects of this repositioning?

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

Yes, I mean, second quarter and third quarter, Mike, have been basically flat. We are seeing that come up in the fourth quarter. And then that will continue to expand into 2016.

We've made a very strategic intent around our FCC business to be strong where we believe those refiners will be strong for now and in the future. And we believe that is in the Middle East, it is in Asia, as well as North America. Europe -- we are positioned in Europe, but -- we are positioned to be there competitively. But strategically it is going to be North America, Middle East, and Asia.

Mike Ritzenthaler - *Piper Jaffray - Analyst*

That makes sense. Shifting gears a little bit to GCP, I guess, to what extent are we seeing sort of a wave of new construction projects? Just trying to gauge the -- clearly a lot of momentum behind that business now, but looking into 4Q and, maybe even more importantly, 2016, as construction spending seems to be ratcheting up and different commercial and industrial applications currently are moving in that direction, is there -- in terms of your outlook for projects that you are bidding on now, things like that, looking out into 2016, are we in a bit of a wave here? Or is that something that is going to continue, do you think?

Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

Mike, this is Greg Poling. Thanks for the question. Actually, we are seeing good project growth in the number of segments around the world -- North America, of course, the construction spending is up. We've seen the commercial accelerating for us in the North American market. We've seen good projects in the Middle East and in the ASEAN markets.

And one good indicator for us on your question is our pipeline on our specialty building materials. And we are seeing good specification work in those markets where we see the growth. Of course, you see a little bit of downturn in -- actually, in Brazil you see some downturn; China; but in the markets that -- North America, the UK, the Middle East, the ASEAN countries, we are seeing good pipelines going forward.

Mike Ritzenthaler - *Piper Jaffray - Analyst*

Okay, thanks, Greg.

Operator

Mike Sison, KeyBanc.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Nice quarter there. In terms of FCC, Fred, you had mentioned six new refineries for FCC, and it is coming this year, or maybe eight in total. How much of the growth in your business does that support? And then when you think about 2016, do you have a forecast of how many units will come on and how much growth that kind of provides you and maybe the industry?

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

Yes, you know, I don't have the forecast for 2016. A number of these units are coming on now and some coming on at the end of the year. For us, I believe our capacity utilization by mid-2016 is going to be basically around 95%, which is -- for us that is just sold out. Operating higher than that -- you really can't with any consistency. I also believe for the industry it will be approximately the same.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Okay, great. And then in a sold-out position, what type of organic growth does that sort of give you in 2016 versus 2015 for catalysts?

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

You know, if you look at our FCC catalysts and you look at our specialty catalysts -- I am going to give you the specialty catalysts first. Our specialty catalysts has grown about 6%, about 6% to 8% this year. It will exit the year in that range on the specialty side of it.

From an FCC side from an organic growth, there is industry growth and then there is unit growth. And I want to be clear about that. From an industry growth, I think the industry growth -- our estimation will be around 3% to 4% on an industry basis. And then based on the unit growth, I think it is going to be a little bit higher.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Great. And then one quick one for Greg. I think you talked about Europe, China, Brazil being down in the quarter. Can you maybe give us the cadence for those regions? Is it -- are we bottoming? Is it stable as you look to the fourth and maybe heading into 2016?

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Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

Yes, sure Mike. Actually, in Europe the area that you have some issues because of the geopolitical problems are in Turkey. But the European market, we are actually seeing that coming up. And we saw a little bit of growth in some of the core Europe. And UK has been pretty good.

Brazil is having both -- you know, we get full translation as well as volume declines. I think the Brazil market is going to be challenged on a volume basis next year.

And China is slower. It is about 5% of our sales. But frankly, the opportunities in both those countries over the long-term are very good for us. And we see some trends in China on the types of construction that should help us. But the near-term outlook in China is a little soft as well.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Okay, great, thank you.

Operator

Jim Barrett, CL King and Associates.

Jim Barrett - *CL King and Associates - Analyst*

Greg, this is a question for you, a two-part question. First, in the earnings release, the improved pricing primarily resulted from inflation in Venezuela. Are you seeing any price improvements in your SCC business in North America?

And then the related question is: as you look into 2016, my recollection is that there is a number of petroleum input ingredients for those product lines. Are you seeing any cost savings related to that?

Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

Sure, Jim. You are right. In terms of the pricing that we saw in the quarter, it was primarily due to Venezuela. We are getting nice margin expansion. We are focused on our mix within the product line in terms of selling the appropriate products to drive the mix and meet our customers' demands as their volumes grow.

So in North America, we are seeing that mix shift favorably. And we are maximizing on our margins in terms of what we are selling -- that similar strategy in each one of these geographies where we are getting some growth. On the input costs, we are capturing the input deflation that you are seeing derived from oil.

If you sort of look at our business across the board, maybe it is 25%, 30% of our raw materials come out of that supply chain, the oil-derived. And we are seeing some support there. There is other materials, of course, in these formulations that are not derived from oil. We are capturing some of that deflation as we go forward.

Jim Barrett - *CL King and Associates - Analyst*

Okay, well, thank you very much.

Operator

John McNulty, Credit Suisse.

John McNulty - *Credit Suisse - Analyst*

So, first one was -- I believe you had indicated throughout the quarter the materials platform actually got stronger, I guess. What were some of the drivers behind that?

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

In Europe, we started to see small but still some positive shoots in our coatings, our silica that went into coatings, across the sector as well as in Asia. So again, starting to feel a little bit better. We will see if it -- and we are hoping it continues, but we will see. We're not expecting a tremendous growth in the fourth quarter. Relatively flat for materials third quarter over fourth quarter.

John McNulty - *Credit Suisse - Analyst*

Okay, fair enough. And the Darex kind of -- I don't know if wind-down is the right way to put it, but the shift on the can side in Asia from two-sided cans to one-sided cans, I guess -- how far through that -- when we start to anniversary some of the bigger headwinds there?

Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

Yes, good, John. Let me just explain a little bit. There's two pieces to -- no pun intended -- to that business. The beverage side, which has shifted from two-piece, to three-piece, to two-piece around the world -- that is pretty much done; a little bit of shift still in Asia Pacific.

The piece we are seeing now -- and beverage is probably 65%, 70% of our business. The shift we are seeing now is in the food cans. We are seeing that in North America, accelerated a little bit in North America in the third quarter. We are almost through that in North America. And we have that shift to go in Asia-Pacific and Europe going forward. This quarter, probably 1%; going forward it is 0.5% of growth or so as we work our way out of it over the next year or two.

John McNulty - *Credit Suisse - Analyst*

Okay, great. And then just one last question on the Venezuelan issue. I think you kind of implied it is about a $30 million hit on the earnings side or on the operating income side. In terms of cash flow, is it fair to assume that that is -- it's a much smaller, much smaller implication?

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

John, this is Hudson. From a GAAP cash flow perspective, we have low working capital requirements there. We have low PP&E requirements and so forth. And so from a GAAP cash flow perspective, it is probably the same magnitude as the earnings. But we've been unable to get cash out of Venezuela for a long time. So from a practical perspective, this has no implications for cash flow.

John McNulty - *Credit Suisse - Analyst*

Got it, okay. No, that is more along the lines of what I was looking for. Okay, great, thanks very much.

Operator

John Roberts, UBS.

John Roberts - *UBS - Analyst*

Bloomberg just did a webinar on naphtha, and they highlighted the big exporters of naphtha in the Middle East are going to pull that back into their fuel pool, so that should allow more US condensate to move out into the global market. Is that a trend that would affect the catalyst market materially?

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

No. It could have a slight positive in Europe, where a lot of those FCC units are naphtha-based. But I would not expect a big dramatic change for us.

John Roberts - *UBS - Analyst*

Okay, and I jumped on late; I apologize if this got asked, but I think it's been a while since you reviewed, if US crude exports open up, how you think that might affect the dynamics in the catalyst marketplace?

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

For us, since we are -- we are spread globally. We've got global assets in Europe, Asia; small assets in North America. So we are able to respond where the crude goes, and to be able to refine that. So we are not worried. We are not worried if that does occur.

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

By far, the biggest driver for us is demand for transportation fuels. And how the refineries are supplied have a small effect and oftentimes creates opportunity for us, John.

John Roberts - *UBS - Analyst*

Okay. Is it fair to say almost any change is generally Positive? There it's -- almost always requires an adjustment that you have to do something different, and therefore you get an opportunity?

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

Yes, I mean generally -- unless there is a dramatic slowdown in the world economy and people stop driving and consuming, consuming transportation fuels.

John Roberts - *UBS - Analyst*

Okay, thank you.

Operator

Laurence Alexander, Jefferies.

Laurence Alexander - *Jefferies LLC - Analyst*

Given the tightness that you are seeing in FCC catalyst and stabilization in the industry, how many years do you think tightness could continue before you would start exploring, through the world scale, capacity additions? What would be your criteria to do so?

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

Well, Laurence, as you know, we are planning to put a world scale capacity into the Middle East sometime during 2018. So, based on that, the portfolio and the profile we are seeing today, we think the industry will be supported by that.

Laurence Alexander - *Jefferies LLC - Analyst*

But I guess after that one, is it reasonable to assume, say, an additional one every 3 to 5 years? Or how do you see the cadence?

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

No, I don't. If you look, it took -- gosh, I mean, there has been some incremental capacity added. But these are -- the blocks are between 10 and 15 years worth of -- before the next one would come on. That's our view. And I think at that point in time, you're also going to see some of the alternative fuels maybe take a little bit of that growth out as well.

So as we look at it, at an important piece to keep in mind is we've got multiple catalyst manufacturing operations. We've got a number of them in the US, one in Europe, a small in Asia. And we are able to throttle back those if there is a dislocation and change versus running one big unit. So we've got some of that flexibility.

Laurence Alexander - *Jefferies LLC - Analyst*

Sure, thank you.

Operator

Edlain Rodriguez, UBS.

Edlain Rodriguez - *UBS - Analyst*

Just one quick question. Like in the slides -- this is for materials technologies -- you noted that North America was down in the quarter. What is driving that decline? And do you expect to see a turnaround soon in there?

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

Yes, some of it was just some of the segments that we play in. It was not dramatically down, but it was slightly down -- some of those segments around the consumer segment for us as well as some of the coating, some of the coating applications. So as we are looking forward into it, into the future, we are seeing a slight uptick hopefully in the fourth quarter here.

Edlain Rodriguez - *UBS - Analyst*

Okay, and lastly, on construction products, like how much -- are you seeing any relief from raw materials coming down? I know, like, last quarter, you did not see much of that. So are you seeing much on this quarter?

Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

Yes, we saw some improvement on the raw materials flow-through. And you did see some step-up ex all of the ins and outs on Venezuela on our margin. Some of that is us capturing that raw material improvement as it is flowing through.

Edlain Rodriguez - *UBS - Analyst*

And hopefully that should continue going forward if costs stay at those levels?

Greg Poling - *W. R. Grace & Co. - President, COO, and Incoming CEO of GCP Applied Technologies*

We think that it's a fairly good raw material environment for us.

Edlain Rodriguez - *UBS - Analyst*

It makes sense.

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

Through three quarters, we have captured most of what we will get this year. Raws have taken a little bit of a leg down recently, but we've gotten most of it in our P&L already year-to-date.

Edlain Rodriguez - *UBS - Analyst*

Okay. Thank you very much.

Operator

(Operator Instructions) Tyler Frank, Robert Baird.

Tyler Frank - *Robert W. Baird & Company, Inc. - Analyst*

Can you talk about the dynamic of the order flows that you are seeing for catalyst? Are refiners ordering lower-priced catalysts, given the high volumes in the market? And then can you also touch on if there's any update with Takreer, as well as your thoughts on the outlook for the ART JV in 2016?

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

I will start with the last first. On the ART joint venture, we are -- we continue to have good results there. For the year, we expect to be close to a double-digit earnings increase of 2015 over 2014. And we are continuing to watch when we put the expansion in. The expansion for the ART is scheduled sometime into mid-2018.

From a catalyst -- you have got to break the catalyst down between the specialty catalysts and our refining catalysts side of it. The specialty catalysts will continue to grow at this 6% rate, and that will continue into the fourth quarter.

Regarding our FCC, it is interesting. I would say through this third-quarter specifically, we have seen actually a slowdown of customers willing to try the new product introduction. I think that will probably carry into the fourth quarter. Just based on -- they are running very hard. And to break a new catalyst in, they have got to slow that run rate down.

Now, there is a number of turnarounds that are happening here in the fourth quarter, and we will see. But I am encouraged. As we get into 2016, I think stability will come back into the systems. And I think there will be a better refresh or re-look at some of the new catalysts that we and the industry has developed.

Tyler Frank - *Robert W. Baird & Company, Inc. - Analyst*

Great, thank you. And can you touch on Takreer or give your thoughts around when we may have more information about that?

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

I would encourage you to ask Takreer when that unit is going to be up full and running. You know, running at full shake-out.

Tyler Frank - *Robert W. Baird & Company, Inc. - Analyst*

Great, thank you.

Operator

Chris Kapsch, BB&T.

Chris Kapsch - *BB&T Capital Markets - Analyst*

Fred, you just mentioned the -- a number of refinery turnarounds ongoing. I guess with the lens on sort of domestic refining industry anyway, the operating rates were very strong throughout much of 2015. And then within the last month or so, the utilization rates are down maybe at least 10 percentage points.

So I am wondering what the implications are for your -- I guess more for ART than the FCC business. Do you have visibility to the type of change-out activity that is happening with this -- what people are describing as a greater-than-seasonal turnaround season? Are they skimping on the types of catalysts that they are purchasing, or just the quality of those catalysts? And if you could provide any insight into your visibility into how this turnaround season plays into your demand at ART? Thank you.

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

For ART on the hydroprocessing side, it's -- you've got to really break it down into its pieces. I think that from a hydroprocessing perspective, some of the distillate-type units making diesel probably have not run as hard. And those catalysts have not been changed out -- at least from what we are seeing, have not been changed out as frequently as they had in the past.

From some of the larger fixed-bed or undulating-bed hydroprocessing units, you are seeing turnarounds taking place. And I think some of those turnarounds may be somewhat extended from that standpoint. So it's a little bit of a mixed bag on that side of it. Does that answer the question?

Chris Kapsch - *BB&T Capital Markets - Analyst*

Yes, and then -- but just the type of -- you must have visibility into, as they do these turnarounds, what sort of catalysts are being changed out. Is there any sense that the appetite, given the overall energy industry being under pressure, the appetite for catalysts is skewed towards, I don't know, something less than prime virgin catalysts, or reconditioned catalysts, or just lower-priced, less efficacious catalysts? Any sort of thrifting on their catalyst purchase activity? Thanks.

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

No. We are really -- we are not seeing that. We are not seeing that in the hydroprocessing at all in the segment that we are the largest in, which is in our hydrocracking side. It seems -- it's good. And it's good demand there.

Chris Kapsch - *BB&T Capital Markets - Analyst*

Thanks for the color.

Operator

Matt Schnabel, Wells Fargo.

Matt Schnabel - *Wells Fargo - Analyst*

Can you remind me how the existing debt is going to be treated post-spin -- the term loan in bonds?

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

We've got really two pieces outstanding today. A little over $1 billion of term debt at Grace, with about $1 billion of high-yield bonds. When GCP separates, they will do their own debt raise. We will actually quantify that for you all in the pro formas that we will file here in the next few weeks.

They will then pay those proceeds. The lion's share of those proceeds will get paid to Grace. And Grace will use those proceeds to pay down the term debt -- not pay off, but pay down the term debt. And so at the end of the day, the leverage of the combined companies won't change, but we'll have the effect of having shifted some of it from Grace to GCP.

Matt Schnabel - *Wells Fargo - Analyst*

Okay. So is there a leverage target that we can think about it?

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

Yes. We have said for Grace we would be between 2 and 2.5 times EBITDA. This is net debt to EBITDA is the statistic we use. And for GCP we said 3 to 3.5 times. And nothing has changed in our thinking there.

Matt Schnabel - *Wells Fargo - Analyst*

Great, thanks. That's all I had.

Operator

Chris Shaw, Monness, Crespi.

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

Just quickly, and I might have missed it: what is the difference in the -- you raised the adjusted EPS guidance but did not raise the adjusted EBIT guidance. Was it just the tax rate in there, or (multiple speakers) Venezuela?

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

No, just truing up tax rate and a little bit of share count.

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

Okay, that's all I had. Thank you.

Operator

I'm showing no further questions at this time. I would like to turn the call back to Tania Almond for closing remarks.

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

Okay, great. Thank you, Abigail. 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. Thank you very much and have a great day.

Operator

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