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GRA - Q4 2013 W. R. Grace & Co. Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 05, 2014 / 4:00PM GMT

OVERVIEW:

GRA reported 4Q13 sales of $777m and adjusted EPS of $1.09. Expects 2014 sales to be $3.3-3.4b and 1Q14 earnings to be at or below 1Q13 levels.

CORPORATE PARTICIPANTS

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

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

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John McNulty *Credit Suisse - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2013 W.R. Grace & Co. earnings conference call. My name is Whitley, and I will be your operator for today. (Operator Instructions) As a reminder, this call is being recorded for replay purposes. I would now like to turn the conference over to your host for today, Mr. Mark Sutherland, Vice President of Investor Relations. Please proceed, sir.

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

Thank you, Whitley. And hello, everyone, and thank you for joining us today, February 5, 2014, for a discussion of Grace's fourth-quarter 2013 results released this morning. Joining me on today's call are Fred Festa, Grace's Chairman and Chief Executive Officer; and Hudson La Force, our Senior Vice President and Chief Financial Officer.

Our earnings release and the corresponding presentation are available on our website. To download copies go to Grace.com and click on investor information. Links are available on the upper-right corner of the page.

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

We will also discuss certain non-GAAP financial measures which are described in more detail in this morning's release and on our website. Reconciliations to the most directly comparable GAAP financial measures and other associated disclosures are contained in our earnings release and on our website.

Our comments on forward-looking statements and non-GAAP financial measures apply both to the prepared remarks and to the Q&A. We want to remind everyone that this webcast contains time-sensitive information that is accurate only as of today. Any redistribution, retransmission, or reproduction of this call without Company consent is prohibited.

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

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

All right. Good morning, everyone, and thanks for joining us. Our fourth-quarter earnings finished as expected with strong results Materials Technologies and Construction Products. Both businesses had good quarters, delivering double-digit earnings growth, and showed continuing sales momentum in the first month of the new year.

Catalysts earnings declined in the quarter. More important, though, catalysts sales volume grew 7% sequentially excluding UNIPOL sales, reflecting the progress we are making in recovering FCC catalysts sales lost earlier in the year. We have seven new products in commercial use today and expect them to total about 10% of FCC catalysts sales in 2014. With this progress, Q1 should be the last quarter for lower year-on-year earnings in catalysts. By quarter two, our FCC sales volume should be recovering nicely, and our UNIPOL integration costs will be behind us.

Although we are not satisfied with our 2013 performance, I am proud of the hard work done by our business teams in a challenging year. In catalysts, our team responded to a very tough first half by accelerating the introduction of new products including those targeted at shale oil, heavy feeds, and propylene maximization. These products are an important foundation for improved sales and margin this year.

Materials Technologies continued to expand margins and delivered double-digit earnings growth in the face of slowing emerging region growth and increased currency volatility.

And in Construction Products, continued its upward trajectory, leveraging improved commercial construction activity in North America and better profitability in Europe to increase earnings 21% for the year.

At the Grace level, we improved our key profitability metrics for the fourth consecutive year. Segment gross margins increase to 37.1%; our adjusted EBIT margin increased to 18%; and EBITDA margin increased to 22%.

Adjusted free cash flow increased to $430 million with net working capital days finishing the year at our target. I fully expect to achieve our target of more than $1.2 billion in adjusted free cash flow from 2012 through this year.

2013 also was an important near for improving our strategic and competitive positioning. The UNIPOL acquisition makes Grace number one in polyolefin catalysts and a clear leader in polypropylene catalysts and process technologies.

Early in the year, ART signed an important commercial agreement with Chevron Lummus Global, the world's largest hydrocracking technology licensor. This expanded relationship helped drive double-digit earnings growth in ART in 2013.

In Construction Products, we began capturing the benefits of better commercial construction activity in North America; continued the restructuring of our business in Europe; and completed a small acquisition in Australia that is delivering outsized benefits.

And of course, this is been an important time in our bankruptcy proceedings. As you know, on February 3 we emerged from bankruptcy. Ours was one of the most complex, highly contested bankruptcies in US history. I want to publicly thank all of our valued customers, suppliers, employees, and investors who place their trust in Grace during this challenging time. For that I am extremely grateful.

Many people have asked me, what will change after bankruptcy? And the answer is that we will be the exact same Company working towards the exact same goals -- growing through product innovation, geographic expansion, and bolt-on acquisitions in our core businesses; continue to improve our profitability through value pricing, product mix improvement, and ongoing improvements in productivity. We will use our strong cash flow as an asset to invest in our businesses. We will continue to reward our investors with high returns on invested capital.

To that final point, we're pleased to begin returning cash to shareholders again. Our Board has approved a $500 million share repurchase program that we expect to complete over the next 12 to 24 months.

Turning to 2014, we expect adjusted EBIT of $620 million to $660 million, an increase of 13% to 20% compared to 2013. We are well positioned to deliver our 2014 targets and are excited about the new year.

With that, I will turn the call over to Hudson to provide some more specifics on the quarter and 2014.

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

Thank you, Fred. Please turn to page 6, and we will start with a quick review of Grace's overall results for the quarter. Sales were $777 million, down 3% from last year due to lower FCC catalysts sales. Adjusted EBIT was $139 million, a decrease of 4%.

Lower earnings in Catalysts Technologies more than offset higher earnings in Materials Technologies and Construction Products and lower corporate costs.

As expected, UNIPOL broke even on operating basis in December before acquisition, integration, and transition costs of $8 million.

Adjusted free cash flow was $430 million for the year. Improved working capital performance and lower cash taxes more than offset lower adjusted EBIT and higher capital spending.

Adjusted EBIT return on invested capital decreased to 27% due to lower segment operating income in Catalysts Technologies and higher invested capital due to the UNIPOL acquisition.

Adjusted EPS was $1.09 based on diluted shares of 78.2 million. Our adjusted tax rate was 33%, in line with our expectations.

Let's turn to Catalysts Technologies on page 7. Fourth quarter sales for Catalysts Technologies were $293 million, down 11%. Sales volume decreased 9%. Rare earths surcharges and base pricing decreases 6%. These decreases partially were offset by acquisition growth of 2% and favorable currency translation of 3%.

FCC catalysts sales volumes decreased 8% year over year, reflecting the sales lost after our pricing initiative earlier in the year and the tough compare. More importantly, FCC catalysts sales volumes increase 6% sequentially, including sales of new products introduced in Q3 and Q4. We have seven new products in commercial use today, and we expect these products to total about 10% of FCC catalysts sales in 2014. The competitive dynamic appears healthy and focused on product technology and technical service.

Specialty catalyst sales increased 3% year over year. Higher polyethylene and UNIPOL sales offset a decline in other polypropylene catalysts sales primarily due to the completion of a toll manufacturing contract early last year.

The UNIPOL integration is proceeding very well. In 2014, sales and earnings from the acquisition are expected to be in line with our previous comments. 2014 adjusted EBIT include $9 million to $11 million in acquisition, integration, and transition costs with about three-quarters of those costs in Q1. We are achieving costs and capital synergies as planned with most but not all of the cost synergies captured in 2014 earnings. UNIPOL depreciation and amortization will be about $15 million in 2014.

Our share of ART's net income was $6 million, up 23% from last year, reflecting good growth in our hydrocracking business.

Catalysts Technologies' segment gross margin decreased to 38.8% for the quarter compared with 41% last year primarily due to lower pricing and lower operating leverage. Some UNIPOL acquisition costs are reported in cost of goods sold and reduced gross margin about 70 basis points. Segment operating margin was 27%, a 430 basis points decrease due to lower sales in segment gross margin and acquisition costs of $8 million, or about 270 basis points.

Looking forward, we expect an improved FCC catalysts environment in 2014 with industry demand growing above the 2% to 3% historical rate. New refinery starts in the Middle East and Asia, heavier feeds, and continued demand for propylene all point to stronger catalysts demand in 2014. We have seen some slow down and European refineries, but that should be offset by continued growth in the emerging regions.

We expect polyolefin catalysts volumes to grow in the mid-single digits this year.

Let's turn to Materials Technologies on page 8. Fourth quarter sales from Materials Technologies were $215 million, an increase of 2% from last year. Organic growth of 3% was partially offset by unfavorable currency translation. Sales of silica-based engineered materials increased 5% based on growth in almost all global regions. North America sales increased 13%; Western Europe increased 1%; and emerging regions increased 6%.

Segment gross margin was 35%, up 70 basis points primarily due to improved pricing. Segment operating margin was 21.4%, up 250 basis points due to higher sales and gross margin and reduced operating expenses. During the past two years, our Materials Technologies team has made great progress improving the fundamentals of their business. Compared with year end 2011, segment gross margin has increased 140 basis points and operating margin has increased 250 basis points. The segment is well-positioned to deliver better sales growth and improve margins in 2014.

Please turn to page 9 for Construction Products. Fourth-quarter sales for Construction Products were $269 million, an increase of 4%. Organic growth was 5% and acquisition growth was 2%. Currency translation was 3% unfavorable. Sales in the developed economies, which represents 65% of segment sales, increased 7%. North America sales increased 6%, and Western Europe increased 4%.

This was Western Europe's second consecutive quarter of the year-over-year growth in Specialty Construction Chemicals. Gross margin in Western Europe improved more than 300 basis points due to improved pricing and mix and reduce manufacturing costs. We are pleased with the improvements in our European business results although we remain cautious about construction spending in the region.

Sales in the emerging regions declined 1%, including unfavorable currency impacts of $5 million, or about 5%. Segment gross margin decreased 90 basis points to 35.2% as improved pricing was not sufficient to offset higher raw material manufacturing costs including the impact of unfavorable currency movements. For the full year, gross margin improved 80 basis points to 36%.

Segment operating income increased 17% year over year, and operating margin improved 160 basis points to 14.1%. Construction Products' full-year segment operating income increased 21% to $152 million with an operating margin of 14.3%, roughly equal to our earnings and margins at their prior peak. With continued recovery in commercial construction spending, particularly in North America, we expect to again grow Construction Products earnings double digits in 2014.

Let's turn to our outlook on page 11. Our outlook for 2014 adjusted EBIT is $620 million to $660 million, an increase of 13% to 20% over 2013. Given the uncertainties over growth rates in the emerging regions and the likelihood of currency volatility as financial markets adjust to changing global economic conditions and policies, our outlook reflects lower expectations for emerging regions' sales and earnings in 2014.

We expect full-year sales to be $3.3 billion to $3.4 billion with organic growth of 5% to 8% based on an assumed GDP growth rate of 2.8%. We also expect acquisition growth of about 4% and currency and rare earth-related headwinds of about 1%. Volume is expected to be a much bigger component of organic growth than pricing.

We expect segment gross margin to be in the range of 37% to 39%. Our segment gross margin target has increased by 200 basis points since 2012.

For Catalysts Technologies, we expect solid double-digit earnings growth driven by improved FCC catalysts sales and UNIPOL earnings. We also expect ART's earnings to grow about 20% again. As you know, we are taking a steady and deliberate approach to recovering our position in the FCC catalysts markets. As a result, 2014 will be more back-end loaded than usual.

As Fred said, Q1 catalysts earnings will be below last year reflecting lower FCC catalysts volumes, lower specialties catalyst volumes resulting from the completion of the toll manufacturing contract mentioned earlier, and the UNIPOL acquisition costs. Q2 earnings should grow mid-single digits. Then we expect strong double-digit earnings growth in Q3 and Q4. We expect margins to improve at least 100 basis points for the year.

For Materials Technologies, we expect mid- to high-single-digit earnings growth on mid-single-digit sales growth and modest margin expansion. This segment is the most sensitive to changes in global GDP and should produce better sales growth as economic growth improves in the developed economies.

For Construction Products, we project another double-digit increase in earnings driven by sales growth and margin improvement. We assume 4% to 5% growth in global construction spending with continued recovery in North America, relative stability in Western Europe, and slower growth in the emerging regions.

Our plan assumes an average euro exchange rate of $1.35 for the year, about where the exchange rate is today. Other currencies have already changed significantly since we set our plan. Although the net effect of these changes is small at this point, we recognize that currency volatility could have a larger impact on our results over the course of the year. We operate in Venezuela and Argentina and have exposure to currency devaluations in both countries. We have mitigated these exposures but cannot eliminate them.

Interest expense of approximately $40 million includes the cost of our exit financing and continuing non-US debt. We completed our exit financing Monday, borrowing $900 million at average initial rate of just over 3%. The revolver and delayed-draw term loan are on drawn at this time.

Our earnings also include approximately $50 million of noncash interest accretion on the deferred payment obligations. The deferred payment obligations were valued at $567 million at emergence and will accrete at a rate of 9.6% per year. We are not adjusting for this expense since it will be included in our results for many years.

We expect our 2014 adjusted tax rate to be 35% with a cash tax rate of 10%. We generated a US federal NOL of approximately $670 million at emergence and obviously want to maximize its net present value. Based on this NOL, the tax benefit of the warrant settlement, and other tax attributes we have, we expect to pay no US federal income taxes into 2018, approximately two years longer than previously noted.

We are again targeting adjusted free cash flow of over $400 million, including capital spending of $160 million to $180 million. As you know, we closely managed the timing and size of our capital investments. Accordingly, we may accelerate or delay our planned capital spending depending on how our growth opportunities develop over the year.

Let me touch on Q1 and the other quarters before opening the call for your questions.

We expect Q1 earnings to be at or below Q1 2013 levels due to lower Catalysts Technologies earnings and higher corporate costs. Q1 has also been affected by the extreme cold weather in North America. We have experienced higher energy costs, limits on gas supply at one manufacturing plant, and some disruptions to manufacturing and logistics operations. Together these effects have reduced our expected Q1 earnings by about $3 million. Obviously, we are working to mitigate these effects, but we do not expect to offset them all.

Beyond Q1, we expect 2014 to be weighted more toward the second half, reflecting the earnings pattern for Catalysts Technologies I described earlier. We expect earnings to split roughly 45%/55% for the first and second halves with Q3 the best earnings quarter of the year.

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*

Fred and Hudson, if I heard you right, there will be down year over year first quarter for catalysts. And I believe that probably also implies some sequential erosion. And given the momentum you had sequentially, just curious what is going on there, if it is more of an FX hit in some of those manufacturing and higher energy costs you were talking about or if there's anything else going on that might affect the lumpiness that you sometimes get in the JV income or any other color on why might be down little bit sequentially.

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

Brian, it is Fred. Primarily it is first and foremost is we've got $9 million to $11 million of UNIPOL acquisition costs, transition costs, services, inventory write up all hitting in the first quarter. That will be behind us, almost all of it exiting the first quarter. That, together with a little bit of -- as we talked about -- the weather issues and so on, are the big drivers there.

Regarding the FCC side, we've got a couple turnarounds, big turnarounds that are planned for major customers. But we're still seeing FCC up sequentially. We will see it up sequentially over the fourth quarter to the first quarter. We feel good about that. We feel good about that side and our adoption of our new products.

Brian Maguire - *Goldman Sachs - Analyst*

Okay, great. On construction, I think you mentioned some raw material pressure. I was curious to see how your efforts to offset through higher pricing are going. And hearing some of your customers out there with 5% or 6% price increases, seems like they are getting traction. Wondering what your outlook for construction pricing might be in 2014.

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

First and foremost, significant raw material increases in the underlying -- in Latin America and Brazil, Argentina, Venezuela primarily is a result of currency. We are behind on that. We hope to catch up by the end of the first quarter on that side.

But generally, the market has been good. We have seen announced pricing increases in cement for 2014. We will see how all those stick. But generally there is a recognition that the commercial construction activity is coming back, and the value pricing is paying off. So again, we need to catch up on the Latin America side, which I think we are well positioned, and the general trends are positive on underlying construction pricing.

Brian Maguire - *Goldman Sachs - Analyst*

Just one last one if I could, for Fred. Hoping we could get some insight into the Board's thinking on the initial side of the share repo. At $500 million, it seems like it is only in line with the free cash flow that you're going to generate over the next, call it 15 months or so. Your thoughts on opportunities to use the balance sheet to buy back more or maybe pursue some M&A.

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

We looked at it. We want to maintain our financial flexibility. As you know, we got the agreement to retire the 10 million shares so we look at that warrant, taking that off the table as part of this program. We want to keep our financial flexibility open as we go forward. And obviously, we are in active dialog with the Board every quarter. And we will see how this all plays out.

Operator

Mike Ritzenthaler, Piper Jaffray.

Mike Ritzenthaler - *Piper Jaffray & Co. - Analyst*

First, I just want to offer my congratulations on the emergence milestone. And then getting into some of the questions, can you elaborate a bit about the competitive dynamics in the emerging economies a bit more? How you are responding to the softer economic growth? And I guess I am asking in the context of the construction and materials segments because those seem to be a little bit more GDP sensitive. But perhaps you can just elaborate or speak to the broader portfolio as well.

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

Construction and engineered materials, primarily the silica side, is the most sensitive to that. I think what you are going to see this year -- I know what you are going to see this year is us going deeper. We are looking for deeper market penetration in the emerging regions where we have a nice position. In the past, we have grown nicely on it, but it has been more cross the broader breadth. Construction chemicals, you will see it, China, cement focused. You will see it waterproofing focused and across Asia on the specialty waterproofing products. Latin America, you will see it in the chemicals, the chemical side for construction.

Engineered materials, a similar story. We will focus deeper on that penetration around the markets that we play well in. In Asia, it is around coatings, on the coatings side, with some new products and so on.

So a little bit -- probably a little bit more sharper focused; looking for the deeper penetration versus a wider spread.

Mike Ritzenthaler - *Piper Jaffray & Co. - Analyst*

That makes sense. And then within catalysts more specifically, is it safe to assume that the lower based pricing called out in your prepared comments, is it a continuation of this customer and mix phenomenon that we saw in the 3Q results?

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

Yes, it really is a mix. Again, we have been very transparent about this. Regarding Asia, it is a mix of our Asia business. In Asia and some of the state-owned enterprises, that rare earth price mechanism is not an adjusting mechanism, and that had some impact on us and so on. But I really do -- I really would call it out as a mix versus a degradation of pricing.

Mike Ritzenthaler - *Piper Jaffray & Co. - Analyst*

Sure, something that can come back over time. Just one last really quick one, maybe for Hudson on working capital. Progress there has been meaningful over the last couple of years, but does it feel at all like the low-hanging fruit has been picked that this point or is there more than we do you feel going forward?

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

We can definitely continue to improve our working capital. I think in terms of total dollars, the working capital investment will go up in 2014 versus 2013. But on a days basis or an efficiency basis, we continue to expect to get better.

Operator

John McNulty, Credit Suisse.

John McNulty - *Credit Suisse - Analyst*

Congratulations again for making it through the reemergence.

Just a couple of quick questions. With regard to the emerging markets and in particular, China, it seems like things have slowed a reasonable amount. Trajectory-wise, are things getting worse in the area? Or are they just at a slow pace and you expect it to stay that way?

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

Yes, it is [slow]. For us, it is probably down from 8% to the 6% type of range, on that side. We're not seeing a dramatic decrease. We have been over the past 24 months, very focused. We're emphasizing construction, our cement versus our concrete additives. Waterproofing in some new commercial buildings there on that perspective side of it. So, it is volatile, but I would say over the last probably four or five months it seems to have steadied around this, for us, around the 6%-type growth rates.

John McNulty - *Credit Suisse - Analyst*

And then with regard to the buybacks, should we be thinking about the share repurchases as opportunistic and that is how you will execute them? Or is it going to be more a pretty steady relative consistent-type program?

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

John, I think it will be a mix. There will certainly be a slow and steady piece to this. But even to Brian's earlier point, we will be opportunistic. And if we see an opportunity we will be more aggressive about it, no question.

John McNulty - *Credit Suisse - Analyst*

And then just maybe one last question. Obviously, you have been financially strong for quite a while but has the bankruptcy reemergence, does that help with any potential customers in terms of opportunities where they just for one reason or another could not do business with you but now they can? Or is that really not the case?

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

No, on the customer side, we got over that hurdle probably, I don't know, eight years ago on that side. I do expect to get some better terms from some of our vendors that have held on by their fingernails because of our Chapter 11 situation.

John McNulty - *Credit Suisse - Analyst*

Okay, great. Thanks very much for the color.

Operator

Mike Sison, KeyBanc.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Congratulations, as well. Fred, in terms of now that you are out of bankruptcy, any changes in the terms of how you manage the Company? Are there projects that you can do on a capital basis that maybe you wouldn't have done in the past? Maybe just talk about how the opportunities now that you have post-bankruptcy.

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

Tactically, it really hasn't changed. I would say strategically where we may be a little more open to explore avenues that could lead down further paths or wind itself to either larger transactions or something on that side, we will tend to follow that path a little further than on the Chapter 11 side. But from a pure acquisition, if we saw a target, that will not change. But I think you will see us be a little more [acquisitive] on the other piece of it.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Okay. And then in terms of FCC catalysts, can you give us a feel for where you think industry operating rates ended this year? And as 2014 unfolds, where do you think that will go? And could that be a positive for pricing as you look into 2014?

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

From our perspective we are at just over a 90% utilization coming into this year. Our best intelligence says the industry should be close to that rate. There are some major units coming on over 2014. So we will see how that whole dynamic plays out. But I do believe -- I feel good about where we are in our new products with our commercial trials and the commercial uses we had. And this those proof statements continue to play itself out with our customers and potential new customers, that will be the opportunity -- the opportunity to capture some value both from a customer perspective and hopefully from our perspective.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Okay. And then when you take a look at your second half outlook, and you think about particularly in catalysts where it does seem you have some control, maybe the ability to win new wins, and then HPC tends to be a big project order. How much of that outlook in the second half do you think is, reasonably speaking, within your control versus waiting for a second half recovery to flow through as we have for the last couple of years?

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

You've got to cut it back. If you look at catalysts, almost a good 6% of that growth is going to come from our UNIPOL acquisition. We feel good about the UNIPOL side. We've got very good visibility on the licensing side and generally very good visibility on the catalysts sales, that piece of it.

ART is a lots of big orders. So visibility is very good on that side of it. And a big step up in the hydrocracking that will continue. From an FCC standpoint I think you will see us be steady and deliberate as we go here in making those improvements.

So as we look at what is complicating the factor is we've got a lot of costs in from his inventory step up on UNIPOL, transition services and so on. And the quicker we get off those transition service agreements, the better we have. So we are pushing hard on that side of it.

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

I will add one thing, Mike, to Fred's comments. Our economic model that this is built on is conservative relative to what the major economic forecasts have for 2014. We think we have stripped out the growth that we have all been waiting for the last couple of years and tried to have a more realistic economic outlook for 2014.

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

I will add one other piece because this is what we talk about. On a total earnings EBIT basis for the full year for the Corporation, a third of it is coming from UNIPOL; a third of it is coming from volume and growth; and here is the other third that probably wasn't as clear as we should have explained in our statement -- a third is coming from productivity. We expect to improve our margins 100 basis points, or 1 point, 2014 over 2013 based on all the restructuring we did in construction in Europe and the volume leverage given the productivity in the plants that we have. So that we feel good about and have some good visibility.

So it is really a third UNIPOL; a third margin expansion; and as Hudson said, the volume growth side is less than we put over 2013.

Operator

Laurence Alexander, Jefferies.

Rob Walker - *Jefferies & Company - Analyst*

This is Rob Walker on for Laurence. Congrats again. Just a follow-up on FCC volume trends. The 6% growth sequentially this quarter, much better than normal seasonality, up Q1 versus Q4, better than normal seasonality. This probably can't be explained fully by the new product adoption. Is there a bit of a catch up? Or just what are your expectations for volume growth for those products in 2014?

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

Well, Rob, as we have said, the new products are part of what is driving the sequential improvement, but it is all in the context of recovering the market position that we lost middle of 2013.

Rob Walker - *Jefferies & Company - Analyst*

And what are your expectations for volume growth in FCC for 2014?

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

We think we will exit on a run rate that would have us recovering the volume that we lost this year. It is about 4% up year over year.

Rob Walker - *Jefferies & Company - Analyst*

Okay, thanks. And can you provide a little more information about the net operating losses you talked about? Why is there two more years of offset?

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

This is tax planning that we have been able to do, optimizing the tax attributes that we have as a Company. And as we took a fresh look at things over the last three or four months now, with certainty around the time of our emergency and things like that, we were just able to optimize that strategy. And as a result, it gave us a couple more years of tax yield in the United States.

Rob Walker - *Jefferies & Company - Analyst*

Okay, thanks. And if I can squeeze one more in, the volume growth in emerging markets in GCP has been pretty flattish the last two quarters. Do you expect volume growth in those regions in 2014?

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

About 2%.

Operator

Dmitry Silversteyn, Longbow Research.

Dmitry Silversteyn - *Longbow Research - Analyst*

Let me add my congratulations on a good way to finish the year and coming out of bankruptcy.

A couple of questions, if I may. When you talk about FCC pricing expectations for 2014 and track it, you coupled that from possible continuing rare earth passed through surcharge removals. Do you expect FCC pricing to be up in 2014 versus 2013? And is there a goal in mind that you have of the next level of pricing that you are going to try to take that business to?

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

We expect it to be flat, 2014 over 2013. Now as we keep getting the proof statements back on our customer trials and get some good data back on that side of it and that value proves out, there will be opportunities. But our expectation overall, it is flat. That is what we've got [on it].

Dmitry Silversteyn - *Longbow Research - Analyst*

So you are looking at some possible mix-driven price improvement if these new products catch on, but not necessarily across-the-board price increase but better than characteristic prior to the rare earth spike a couple of years ago?

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

Dmitry, that's right.

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

We will see margin expansion as we get our operating leverage back and the productivity that Fred spoke about, but it is more controllable than the pricing side.

Dmitry Silversteyn - *Longbow Research - Analyst*

Got you, very good. You provided some pretty good color and granularity on the growth expectations and some of the targeted areas to grow in the construction side of the business. You mentioned coatings as an area of growth in Asia for the materials part of the business. Can you talk about other areas of materials that are particularly leveraged, let's say, to GDP particular in North America and Europe where it sounds like things are going to be a little bit better versus Latin America and Asia?

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

Yes, let me give you an overview. If you think about our call Materials Technologies segment, we think it could go between on a revenue basis, 6% to 7%. We think 4% to 5% of that is going to come from market growth around the globe. And we've got nice positions in the emerging markets, which we will benefit from.

We also have pricing opportunities in the Darex, the coating, Darex coating and sealant platform. Those are really fundamentally driven by underlying raw material pricing. As that goes up, we have been able to capture that side.

And then another 1%, possibly 2%, some new products. We've got some new, exciting products on the Discovery Science side in the bioscience side of it as well as some across the board.

So we're not betting on a big market recovery in materials. As I said, this 4% to 5%, and then hoping to pick up -- expecting to pick up some on the pricing on the new product side of it.

Dmitry Silversteyn - *Longbow Research - Analyst*

Got it. Okay. Can you talk about your working capital outlook for 2014? You talked about perhaps getting a little bit better rates or terms from some of your vendors. Obviously the UNIPOL acquisition offer some opportunities to play around with working capital. So how should we think about working capital over the 2014/2015 timeframe? Either in absolute dollars or as a percent of revenue, what is your goal?

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

I think from an absolute dollars perspective, our investment in working capital will go up. It will be a bit of a drag on our free cash flow generation just to support the higher sales growth that we expect. But from an efficiency standpoint, we think of it in terms of net working capital days. We expect to continue to get better. We dropped I think it was five days from the end of 2012 to the end of 2013. And as we head from 2013 into 2014, we are looking to improve another day or two. And the primary opportunities there, we do think will have a little better working capital performance with the UNIPOL business.

Fred mentioned that there are some vendor opportunities to extend payment terms although that frankly is fairly small. We are already at an average of about 56, 57 days, I think, on our raw material vendors. So there is little opportunity there, but not too much.

Dmitry Silversteyn - *Longbow Research - Analyst*

Okay. And then final question, you're coming out with $900 million of emerging finance debt. Your revolver, as you mentioned, is undrawn. So what are your goals or expectations for leverage and either debt to EBITDA or debt to interest payments, however you monitor this or however you handicap it inside the Company?

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

Yes, we have got a stated target to have our leverage, our EBITDA leverages -- the metric we use -- between 2 and three turns. I think where we stand right now is at the very low end of that just over two turns with the UNIPOL acquisition and the exit financing. We would expect to increase that leverage over time as we do further acquisitions. There's nothing specific right now but that has been part of our growth strategy, and I think it will be. And if we did return a capital above and beyond our free cash flow, which we are certainly keeping our eyes on those types of opportunities, that would allow us to drive that leverage level up a little bit, too. And (inaudible).

Operator

(Operator Instructions) Jim Barrett, CL King & Associates.

Jim Barrett - *CL King & Associates - Analyst*

Hudson, I think these -- I have two questions that I think are for you. Given that the Company is not now -- expects not to pay federal taxes through 2018, does that increase the inclination of the Board to consider a dividend sooner than it might otherwise?

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

No, what we have announced is the share repurchase program. That is our focus for now. The free cash flow will be higher than it would otherwise have been with the lower taxes, but that's goes more to the amount of capital rather than the way in which we would choose to return it.

Jim Barrett - *CL King & Associates - Analyst*

Understood. And then on your mark-to-market pension adjustment, the Company is not providing an estimate, but should I assume that would be positive if pension assets continue to perform well, other companies are raising their discount rates?

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

I am sorry, Jim. I think I missed your question.

Jim Barrett - *CL King & Associates - Analyst*

Yes, should I assume your mark-to-market pension adjustment for 2014 -- should I assume that will be positive as it was in 2013?

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

Yes. Well, it is a function, as you know, it is a function of what happens with the market return on our assets and then the discount rate on the PBO. And that is -- right now we have about 80% of our pension assets in fixed income. We have been down this de-risking path, as I think we have talked about on earlier calls. That said, we have a net short exposure to long-term interest rates. And as long-term interest rates go up, assuming they continue to, yes, we would expect a positive mark to market. But we will just have to see what happens with interest rates this year.

Jim Barrett - *CL King & Associates - Analyst*

Okay, thanks, and congratulations, everyone.

Operator

Chris Shaw, Monness, Crespi.

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

Congrats again. Just on FCC, I was looking back. You had year-over-year FCC volumes in the third quarter down 8%, which is similar to the fourth quarter despite the sequential increase. Now, is that just is that in part due to the seasonality and in part to, I think someone mentioned a tough comp earlier? And if it is a tough comp, could you just remind me what made the comp so tough?

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

Yes, it is primarily the comp side of it. We had some big European orders hit in last year's fourth quarter, Eastern European orders that are exasperating that.

Remember, let me just refresh. We have been transparent. We said that we lost about $65 million of revenue on the FCC side throughout 2013. So you put that in context, we are gradually trying to, with these new product introductions, capture some of that as we go back in 2014 here.

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

And then Construction Products, you spoke this quarter. I think that emerging markets volumes were down or sales were down, much of it in the volume number. And it sounded like before you were talking about China was up. But is that all just Latin America? And if so, how much of that is currency? I'm trying to figure out how bad demand Latin America is exactly.

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

It is really currency, Chris. We had a $5 million currency bad guy in Q4 just in Latin America. And if you take that out, the emerging region growth in construction in Q4 was plus 4%, I think.

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

That's all I had. Thanks again.

Operator

Brian Maguire, Goldman Sachs.

Brian Maguire - *Goldman Sachs - Analyst*

Just a couple of quick follow-ups. On the 10% of 2014 sales you hope to get from the new products, can you disaggregate or give a sense whether that will be weighted more towards cannibalizing existing sales to the existing customers or new business wins?

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

It will be about 50/50.

Brian Maguire - *Goldman Sachs - Analyst*

Okay, great. And then the last two, I think, for Hudson. Just on the cash tax rate as you extend that NOL out to 2018, is it going to stay at 10%? And will the book rates stay at 35% or do they start to converge as you get closer to 2018?

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

They will start to converge as we get closer to 2018. But as you think about 2014, 2015, 2016, I think that 35% and 10% is probably right. It is at 12% instead of 10% -- yes, but it is not going to be a 20% cash tax rate. It will stay low until we burn through all of those tax attributes.

And then in the 2017, 2018, 2019 timeframe, they will converge at some mid- to maybe higher 20%-type number.

Brian Maguire - *Goldman Sachs - Analyst*

Okay, great. And just one last one, any need to revalue the DPO now that you have emerged or to reevaluate the discount rate you are using to present value it?

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

No, once we emerged it was fixed. And it will be fixed throughout its life.

Operator

Mike Ritzenthaler, Piper Jaffray.

Mike Ritzenthaler - *Piper Jaffray & Co. - Analyst*

Just a quick follow-up on the industry dynamics within the polyolefin catalysts family. So we have heard that globally we should be long certain alkyls and polyethylene catalysts for a couple of years, perhaps, with the new capacity that has come online. Is your catalyst business sensitive to that at all? Obviously, UNIPOL is in a separate world from that, but just wondering if there is any sensitivity that your catalyst business has to those types of dynamics and if you are seeing the same thing.

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

Not especially. Not really. It is on the polyethylene side. If any sensitivity, would probably come in some of our single site, new single site products that were being developed from some customers. And that may just be am the timing of that. But generally, no, they are pretty stable with our current portfolio.

Operator

John McNulty, Credit Suisse.

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John McNulty - *Credit Suisse - Analyst*

Sorry, just one follow-up. When I think about the catalyst business sequentially and the guidance that it will be down from 4Q to 1Q, I am a little bit confused as to why that would be. I believe there's a little bit of seasonality that normally would give you a little bit of lift sequentially. I know there is some incremental costs coming in from UNIPOL, but at the same time I thought you also had ART having some business pushed out from 4Q to 1Q. So when I and them all up, I don't know if I get to a down sequentially all that much. So what am I missing on all of this?

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

I think it is down sequentially on earnings but from a volume perspective as we look at it -- and it goes to a number of the questions we have had on the call. From Q3 to Q4, we see better sequentially. From Q4 to Q1, we see better sequentially. There is some seasonality in Q1 in FCC catalysts, the turnarounds that Fred mentioned. It doesn't seem to be coming through in the discussion today, but we feel really good about the progress we're making in FCC catalysts on a sequential basis.

Obviously, year over year we're still working through the down effects of the pricing initiative, but on a sequential basis, we feel really good about this.

Operator

Dana Walker, Kalmar Investments.

Dana Walker - *Kalmar Investments - Analyst*

On polyolefin catalysts, can you provide some context? I thought I heard you say you expected other revenue volume to be up low- to mid-single digits. Could you contrast -- assuming that is right, could you expand upon those comments and describe what you saw market wise and Grace-wise in that category over the last few years?

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

Dana, it is Fred. We saw higher growth in the polyolefin business. And one primary driver of these lower growth that we are expecting is one of our major customers, we were toll manufacturing for them, they have brought that catalyst back in house and that is -- it is 3 points. So that really gets us from the high mid-single digits to the low-double digits.

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

I think the thing I would add, just to be clear, that is ex the UNIPOL --

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

That is right. Ex --

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

Ex -- layering on the UNIPOL benefit.

Dana Walker - *Kalmar Investments - Analyst*

So you were up low-double digit in 2013. You expect to be up high-single digit in 2014 largely because of the loss of the tolling.

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

That is correct. Ex-UNIPOL. And then you can add UNIPOL to it. That is right. On the same-store basis.

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

And the business is getting bigger, obviously. As the business base gets bigger, maintaining that double-digit growth was -- we were going to slip into the high-single digits anyway.

Operator

That concludes Q&A. I will now turn the call back over to management. Please proceed.

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

Thank you, Whitley, and thank you all for joining us. For any questions requiring clarification from this morning's call, please feel free to call Mark Sutherland at 410-531-4590. Thank you very much.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.
