

W R GRACE & CO  
Form 10-Q  
July 28, 2017

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the Quarterly Period Ended June 30, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

Commission File Number 1-13953

W. R. GRACE & CO.

(Exact name of registrant as specified in its charter)

Delaware

65-0773649

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

7500 Grace Drive, Columbia, Maryland 21044-4098

(Address of principal executive offices) (Zip Code)

(410) 531-4000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Outstanding at July 25, 2017

Common Stock, \$0.01 par value per share 68,226,961 shares

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The Financial Accounting Standards Board is referred to in this Report as the "FASB." The FASB issues, among other things, Accounting Standards Codifications ("ASC") and Accounting Standards Updates ("ASU").

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Review by Independent Registered Public Accounting Firm

With respect to the interim consolidated financial statements included in this Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, has applied limited procedures in accordance with professional auditing standards for a review of such information. Their report on the interim consolidated financial statements, which follows, states that they did not audit and they do not express an opinion on the unaudited interim consolidated financial statements. Accordingly, the degree of reliance on their report on the unaudited interim consolidated financial statements should be restricted in light of the limited nature of the review procedures applied. This report is not considered a "report" within the meaning of Sections 7 and 11 of the Securities Act of 1933, and, therefore, the independent accountants' liability under Section 11 does not extend to it.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of W. R. Grace & Co.:

We have reviewed the accompanying consolidated balance sheet of W. R. Grace & Co. and its subsidiaries as of June 30, 2017, and the related consolidated statements of operations and comprehensive income for the three-month and six-month periods ended June 30, 2017 and 2016 and the consolidated statements of cash flows and equity for the six-month periods ended June 30, 2017 and 2016. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, comprehensive income, equity and of cash flows for the year then ended (not presented herein), and in our report dated February 23, 2017, which included a paragraph describing a change in the manner of accounting for debt issuance costs and stock compensation in 2016, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2016, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP  
Baltimore, Maryland  
July 28, 2017

Table of ContentsW. R. Grace & Co. and Subsidiaries  
Consolidated Statements of Operations (unaudited)

(In millions, except per share amounts)	Three Months		Six Months	
	Ended June 30, 2017	2016	Ended June 30, 2017	2016
Net sales	\$429.5	\$390.5	\$827.5	\$753.3
Cost of goods sold	260.2	217.3	505.0	427.4
Gross profit	169.3	173.2	322.5	325.9
Selling, general and administrative expenses	70.3	66.4	136.8	134.4
Research and development expenses	12.9	12.4	26.1	24.1
Provision for environmental remediation, net	13.2	5.3	13.2	7.5
Equity in earnings of unconsolidated affiliate	(6.1 )	(2.6 )	(13.1 )	(9.5 )
Restructuring and repositioning expenses	5.4	9.4	7.7	23.0
Interest expense and related financing costs	20.1	19.8	39.6	41.8
Other (income) expense, net	(9.6 )	3.1	(11.8 )	13.8
Total costs and expenses	106.2	113.8	198.5	235.1
Income (loss) from continuing operations before income taxes	63.1	59.4	124.0	90.8
(Provision for) benefit from income taxes	(19.6 )	(21.5 )	(37.6 )	(42.7 )
Income (loss) from continuing operations	43.5	37.9	86.4	48.1
Income (loss) from discontinued operations, net of income taxes	—	0.6	—	(9.3 )
Net income (loss)	43.5	38.5	86.4	38.8
Less: Net (income) loss attributable to noncontrolling interests	0.4	0.2	0.4	0.4
Net income (loss) attributable to W. R. Grace & Co. shareholders	\$43.9	\$38.7	\$86.8	\$39.2
Amounts Attributable to W. R. Grace & Co. Shareholders:				
Income (loss) from continuing operations attributable to W. R. Grace & Co. shareholders	\$43.9	\$38.1	\$86.8	\$48.5
Income (loss) from discontinued operations, net of income taxes	—	0.6	—	(9.3 )
Net income (loss) attributable to W. R. Grace & Co. shareholders	\$43.9	\$38.7	\$86.8	\$39.2
Earnings Per Share Attributable to W. R. Grace & Co. Shareholders				
Basic earnings per share:				
Income (loss) from continuing operations	\$0.64	\$0.54	\$1.27	\$0.69
Income (loss) from discontinued operations, net of income taxes	—	0.01	—	(0.13 )
Net income (loss)	\$0.64	\$0.55	\$1.27	\$0.56
Weighted average number of basic shares	68.3	70.5	68.3	70.5
Diluted earnings per share:				
Income (loss) from continuing operations	\$0.64	\$0.54	\$1.27	\$0.68
Income (loss) from discontinued operations, net of income taxes	—	0.01	—	(0.13 )
Net income (loss)	\$0.64	\$0.55	\$1.27	\$0.55
Weighted average number of diluted shares	68.4	70.9	68.5	71.0
Dividends per common share	\$0.21	\$0.17	\$0.42	\$0.17

The Notes to Consolidated Financial Statements are an integral part of these statements.

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## W. R. Grace &amp; Co. and Subsidiaries

## Consolidated Statements of Comprehensive Income (Loss) (unaudited)

(In millions)	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income (loss)	\$43.5	\$38.5	\$86.4	\$38.8
Other comprehensive income (loss):				
Defined benefit pension and other postretirement plans, net of income taxes	(0.4 )	(0.4 )	(0.7 )	(0.7 )
Currency translation adjustments	(8.3 )	1.3	(9.7 )	(4.1 )
Gain (loss) from hedging activities, net of income taxes	(0.2 )	(0.3 )	0.5	(3.3 )
Total other comprehensive income (loss) attributable to noncontrolling interests	—	—	—	2.6
Total other comprehensive income (loss)	(8.9 )	0.6	(9.9 )	(5.5 )
Comprehensive income (loss)	34.6	39.1	76.5	33.3
Less: comprehensive (income) loss attributable to noncontrolling interests	0.4	0.2	0.4	(2.2 )
Comprehensive income (loss) attributable to W. R. Grace & Co. shareholders	\$35.0	\$39.3	\$76.9	\$31.1

The Notes to Consolidated Financial Statements are an integral part of these statements.

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## W. R. Grace &amp; Co. and Subsidiaries

## Consolidated Statements of Cash Flows (unaudited)

(In millions)	Six Months	
	Ended June 30, 2017	2016
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$86.4	\$38.8
Less: loss (income) from discontinued operations	—	9.3
Income from continuing operations	86.4	48.1
Reconciliation to net cash provided by (used for) operating activities from continuing operations:		
Depreciation and amortization	54.2	46.8
Equity in earnings of unconsolidated affiliate	(13.1 )	(9.5 )
Dividends received from unconsolidated affiliate	—	16.8
Costs related to legacy product, environmental and other claims	17.0	11.1
Cash paid for legacy product, environmental and other claims	(44.2 )	(6.0 )
Provision for (benefit from) income taxes	37.6	42.7
Cash paid for income taxes	(31.3 )	(26.8 )
Income tax refunds received	29.7	2.3
Loss on early extinguishment of debt	—	11.1
Interest expense and related financing costs	39.6	41.8
Cash paid for interest	(34.3 )	(40.6 )
Defined benefit pension expense	8.2	5.3
Cash paid under defined benefit pension arrangements	(7.8 )	(8.0 )
Changes in assets and liabilities, excluding effect of currency translation and acquisitions:		
Trade accounts receivable	4.3	37.2
Inventories	(3.9 )	(7.7 )
Accounts payable	7.4	7.0
All other items, net	(9.3 )	(34.8 )
Net cash provided by (used for) operating activities from continuing operations	140.5	136.8
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(59.1 )	(57.3 )
Business acquired	—	(245.1 )
Proceeds from sale of product lines	0.6	11.3
Other investing activities	(1.1 )	(0.6 )
Net cash provided by (used for) investing activities from continuing operations	(59.6 )	(291.7 )
<b>FINANCING ACTIVITIES</b>		
Borrowings under credit arrangements	98.8	16.0
Repayments under credit arrangements	(61.5 )	(609.4 )
Cash paid for repurchases of common stock	(30.0 )	(35.1 )
Proceeds from exercise of stock options	12.2	9.2
Dividends paid	(28.7 )	(12.0 )
Distribution from GCP	—	750.0
Other financing activities	(4.0 )	(2.7 )
Net cash provided by (used for) financing activities from continuing operations	(13.2 )	116.0
Effect of currency exchange rate changes on cash and cash equivalents	3.5	1.9
Increase (decrease) in cash and cash equivalents from continuing operations	71.2	(37.0 )
Cash flows from discontinued operations		
Net cash provided by (used for) operating activities	—	23.9



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Net cash provided by (used for) investing activities	—	(9.5 )
Net cash provided by (used for) financing activities	—	31.4
Effect of currency exchange rate changes on cash and cash equivalents	—	(1.0 )
Increase (decrease) in cash and cash equivalents from discontinued operations	—	44.8
Net increase (decrease) in cash and cash equivalents	71.2	7.8
Less: cash and cash equivalents of discontinued operations	—	(143.4 )
Cash and cash equivalents, beginning of period	90.6	329.9
Cash and cash equivalents, end of period	\$161.8	\$194.3
Supplemental disclosure of cash flow information		
Capital expenditures in accounts payable	\$17.8	\$19.7
Net share settled stock option exercises	1.2	\$10.1

The Notes to Consolidated Financial Statements are an integral part of these statements.

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## W. R. Grace &amp; Co. and Subsidiaries

## Consolidated Balance Sheets (unaudited)

(In millions, except par value and shares)	June 30, 2017	December 31, 2016
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 161.8	\$ 90.6
Restricted cash and cash equivalents	10.8	10.0
Trade accounts receivable, less allowance of \$2.4 (2016—\$2.2)	265.0	273.9
Inventories	236.5	228.0
Other current assets	41.4	52.3
Total Current Assets	715.5	654.8
Properties and equipment, net of accumulated depreciation and amortization of \$1,397.6 (2016—\$1,327.5)	749.7	729.6
Goodwill	397.5	394.2
Technology and other intangible assets, net	261.9	269.1
Deferred income taxes	700.3	709.4
Investment in unconsolidated affiliate	131.9	117.6
Other assets	33.1	37.1
Total Assets	\$2,989.9	\$ 2,911.8
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities		
Debt payable within one year	\$86.5	\$ 76.5
Accounts payable	199.9	195.4
Other current liabilities	183.6	208.9
Total Current Liabilities	470.0	480.8
Debt payable after one year	1,516.5	1,507.6
Underfunded and unfunded defined benefit pension plans	444.2	424.3
Other liabilities	153.6	126.7
Total Liabilities	2,584.3	2,539.4
Commitments and Contingencies—Note 8		
Equity		
Common stock issued, par value \$0.01; 300,000,000 shares authorized; outstanding: 68,226,070 (2016—68,309,431)	0.7	0.7
Paid-in capital	474.0	487.3
Retained earnings	677.3	619.3
Treasury stock, at cost: shares: 9,230,557 (2016—9,147,196)	(806.1 )	(804.9 )
Accumulated other comprehensive income (loss)	56.5	66.4
Total W. R. Grace & Co. Shareholders' Equity	402.4	368.8
Noncontrolling interests	3.2	3.6
Total Equity	405.6	372.4
Total Liabilities and Equity	\$2,989.9	\$ 2,911.8

The Notes to Consolidated Financial Statements are an integral part of these statements.

Table of ContentsW. R. Grace & Co. and Subsidiaries  
Consolidated Statements of Equity (unaudited)

(In millions)	Common Stock and Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balance, December 31, 2015	\$496.7	\$436.3	\$(658.4)	\$ (66.8 )	\$ 4.7	\$212.5
Net income (loss)	—	39.2	—	—	(0.4 )	38.8
Repurchase of common stock	—	—	(35.1 )	—	—	(35.1 )
Stock based compensation	6.5	—	—	—	—	6.5
Exercise of stock options	(10.5 )	—	29.8	—	—	19.3
Tax benefit related to stock plans	—	72.3	—	—	—	72.3
Shares issued	0.7	—	—	—	—	0.7
Other comprehensive (loss) income	—	—	—	(8.1 )	2.6	(5.5 )
Cash dividends declared	—	(12.0 )	—	—	—	(12.0 )
Distribution of GCP	—	59.9	—	135.3	(3.7 )	191.5
Balance, June 30, 2016	\$493.4	\$595.7	\$(663.7)	\$ 60.4	\$ 3.2	\$489.0
Balance, December 31, 2016	\$488.0	\$619.3	\$(804.9)	\$ 66.4	\$ 3.6	\$372.4
Net income (loss)	—	86.8	—	—	(0.4 )	86.4
Repurchase of common stock	—	—	(30.0 )	—	—	(30.0 )
Payments to taxing authorities in consideration of employee tax obligations relative to stock-based compensation arrangements	(2.4 )	—	—	—	—	(2.4 )
Stock based compensation	5.4	—	—	—	—	5.4
Exercise of stock options	(17.0 )	—	28.8	—	—	11.8
Shares issued	0.7	—	—	—	—	0.7
Other comprehensive (loss) income	—	—	—	(9.9 )	—	(9.9 )
Dividends declared	—	(28.8 )	—	—	—	(28.8 )
Balance, June 30, 2017	\$474.7	\$677.3	\$(806.1)	\$ 56.5	\$ 3.2	\$405.6

The Notes to Consolidated Financial Statements are an integral part of these statements.

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Notes to Consolidated Financial Statements

1. Basis of Presentation and Summary of Significant Accounting and Financial Reporting Policies

W. R. Grace & Co., through its subsidiaries, is engaged in specialty chemicals and specialty materials businesses on a global basis through two reportable segments: Grace Catalysts Technologies, which includes catalysts and related products and technologies used in refining, petrochemical and other chemical manufacturing applications; and Grace Materials Technologies, which includes specialty materials, including silica-based and silica-alumina-based materials, used in coatings, consumer, industrial, and pharmaceutical applications.

W. R. Grace & Co. conducts all of its business through a single wholly owned subsidiary, W. R. Grace & Co.–Conn. ("Grace–Conn."). Grace–Conn. owns all of the assets, properties and rights of W. R. Grace & Co. on a consolidated basis, either directly or through subsidiaries.

As used in these notes, the term "Company" refers to W. R. Grace & Co. The term "Grace" refers to the Company and/or one or more of its subsidiaries and, in certain cases, their respective predecessors.

**Separation Transaction** On January 27, 2016, Grace entered into a separation agreement with GCP Applied Technologies Inc., then a wholly-owned subsidiary of Grace ("GCP"), pursuant to which Grace agreed to transfer its Grace Construction Products operating segment and the packaging technologies business of its Grace Materials Technologies operating segment to GCP (the "Separation"). Grace and GCP completed the Separation on February 3, 2016 (the "Distribution Date"), by means of a pro rata distribution to the Company's stockholders of all of the outstanding shares of GCP common stock (the "Distribution"), with one share of GCP common stock distributed for each share of Company common stock held as of the close of business on January 27, 2016. As a result of the Distribution, GCP became an independent public company. GCP's historical financial results through the Distribution Date are reflected in Grace's Consolidated Financial Statements as discontinued operations.

**Basis of Presentation** The interim Consolidated Financial Statements presented herein are unaudited and should be read in conjunction with the Consolidated Financial Statements presented in the Company's 2016 Annual Report on Form 10-K. Such interim Consolidated Financial Statements reflect all adjustments that, in the opinion of management, are necessary for a fair statement of the results of the interim periods presented; all such adjustments are of a normal recurring nature except for the impacts of adopting new accounting standards as discussed below. All significant intercompany accounts and transactions have been eliminated.

The results of operations for the six-month interim period ended June 30, 2017, are not necessarily indicative of the results of operations to be attained for the year ending December 31, 2017.

**Use of Estimates** The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses for the periods presented. Actual amounts could differ from those estimates, and the differences could be material. Changes in estimates are recorded in the period identified. Grace's accounting measurements that are most affected by management's estimates of future events are:

- Realization values of net deferred tax assets, which depend on projections of future taxable income (see Note 5);
- Pension and postretirement liabilities, which depend on assumptions regarding participant life spans, future inflation, discount rates and total returns on invested funds (see Note 6);
- Carrying values of goodwill and other intangible assets, which depend on assumptions of future earnings and cash flows; and
- Contingent liabilities, which depend on an assessment of the probability of loss and an estimate of ultimate obligation, such as litigation (see Note 8), income taxes (see Note 5), and environmental remediation (see Note 8).

**Reclassifications** Certain amounts in prior years' Consolidated Financial Statements have been reclassified to conform to the current year presentation. Such reclassifications have not materially affected previously reported amounts in the Consolidated Financial Statements.

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## Notes to Consolidated Financial Statements (Continued)

## 1. Basis of Presentation and Summary of Significant Accounting and Financial Reporting Policies (Continued)

**Recently Issued Accounting Standards** In May 2014, the FASB issued ASU 2014-09 "Revenue from Contracts with Customers." This update is intended to remove inconsistencies and weaknesses in revenue requirements; provide a more robust framework for addressing revenue issues; improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; provide more useful information to users of financial statements through improved disclosure requirements; and simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The new requirements are effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years, with early adoption permitted for fiscal years beginning after December 15, 2016. The standard allows for two methods of adoption: (a) full retrospective adoption, meaning the standard is applied to all periods presented, or (b) modified retrospective adoption, meaning the cumulative effect of applying the new standard is recognized as an adjustment to the opening retained earnings balance. Grace will adopt the standard in the 2018 first quarter. Grace has begun its preliminary assessment and is identifying specific areas of impact on the Consolidated Financial Statements. At this time, Grace cannot reasonably estimate the effect of adoption. Grace has tentatively decided to adopt this standard under the modified retrospective approach and is still evaluating the effect on its financial statements and disclosures.

In February 2016, the FASB issued ASU 2016-02 "Leases (Topic 842)." This update is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term, including optional payments where they are reasonably certain to occur. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. Currently, as a lessee, Grace is a party to a number of leases which, under existing guidance, are classified as operating leases and not recorded on the balance sheet but are expensed as incurred. Under the new standard, many of these leases will be recorded on the Consolidated Balance Sheets. Grace will adopt the standard in 2019 and at this time cannot reasonably estimate the effect of adoption.

In November 2016, the FASB issued ASU 2016-18 "Statement of Cash Flows (Topic 230): Restricted Cash," which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new requirements are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. Grace is currently evaluating the timing of adoption and does not expect the update to have a material effect on the Consolidated Financial Statements. As of June 30, 2017, and December 31, 2016, restricted cash included in the Consolidated Balance Sheets was \$10.8 million and \$10.0 million, respectively.

In January 2017, the FASB issued ASU 2017-01 "Business Combinations (Topic 805)," which provides a screen to determine when an integrated set of assets and activities is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, the amendments in this update (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The amendments in this update also narrow the definition of the term "output" so that the term is consistent with how outputs are described in Topic 606. Public business entities are required to apply the amendments in this update to

annual periods beginning after December 15, 2017, including interim periods within those periods. Early application is permitted. Grace will evaluate the effect of the update at the time of any future acquisition or disposal.

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## Notes to Consolidated Financial Statements (Continued)

## 1. Basis of Presentation and Summary of Significant Accounting and Financial Reporting Policies (Continued)

In January 2017, the FASB issued ASU 2017-04 "Intangibles—Goodwill and Other (Topic 350)." This update modifies the concept of impairment from the condition that exists when the carrying amount of goodwill exceeds its implied fair value to the condition that exists when the carrying amount of a reporting unit exceeds its fair value. An entity no longer will determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination ("Step 2"). Because these amendments eliminate Step 2 from the goodwill impairment test, they should reduce the cost and complexity of evaluating goodwill for impairment. Public business entities are required to adopt the amendments in this update for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Grace is currently evaluating the timing of adoption and does not expect the update to have a material effect on the Consolidated Financial Statements.

In March 2017, the FASB issued ASU 2017-07 "Compensation—Retirement Benefits (Topic 715)." This update requires that the service cost component of net benefit cost be presented with other compensation costs arising from services rendered. The remaining net benefit cost is either presented as a line item in the statement of operations outside of a subtotal for income from operations, if presented, or disclosed separately. Only the service cost component of net benefit expense can be capitalized. Public business entities are required to adopt the amendments in this update for fiscal years beginning after December 15, 2017. Grace is currently evaluating the update's effect on the Consolidated Financial Statements and will adopt the update in the 2018 first quarter.

In May 2017, the FASB issued ASU 2017-09 "Compensation—Stock Compensation (Topic 718)." This update clarifies the existing definition of the term "modification," which is currently defined as "a change in any of the terms or conditions of a share-based payment award." The update requires entities to account for modifications of share-based payment awards unless the (1) fair value, (2) vesting conditions and (3) classification as an equity instrument or a liability instrument of the modified award are the same as of the original award before modification. Public business entities are required to adopt the amendments in this update for fiscal years and interim periods beginning after December 15, 2017, with early adoption permitted. Grace does not currently have any modifications of share-based awards and will adopt the update when it becomes effective.

**Recently Adopted Accounting Standards** In July 2015, the FASB issued ASU 2015-11 "Simplifying the Measurement of Inventory." This update is part of the FASB's Simplification Initiative and is also intended to enhance convergence with the International Accounting Standards Board's ("IASB") measurement of inventory. The update requires that inventory be measured at the lower of cost or net realizable value for entities using FIFO (first-in, first-out) or average cost methods. The new requirements are effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years, with early adoption permitted. Grace adopted this update in the first quarter of 2017, and it did not have a material effect on the Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15 "Classification of Certain Cash Receipts and Cash Payments." This update is intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. It addresses eight specific issues. The amendments in this update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. Grace adopted this update in the 2017 second quarter, and it did not have a material effect on the Consolidated Financial Statements.

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## Notes to Consolidated Financial Statements (Continued)

## 2. Inventories

Inventories are stated at the lower of cost or net realizable value, and cost is determined using FIFO. Inventories consisted of the following at June 30, 2017, and December 31, 2016:

(In millions)	June 30, December 31,	
	2017	2016
Raw materials	\$ 55.3	\$ 57.7
In process	36.0	33.4
Finished products	123.1	115.8
Other	22.1	21.1
	\$ 236.5	\$ 228.0

## 3. Debt

## Components of Debt

(In millions)	June 30, 2017	December 31, 2016
5.125% senior notes due 2021, net of unamortized debt issuance costs of \$6.6 at June 30, 2017 (2016—\$7.3)	\$693.4	\$ 692.7
U.S. dollar term loan, net of unamortized debt issuance costs and discounts of \$5.1 at June 30, 2017 (2016—\$5.7)	403.3	402.7
5.625% senior notes due 2024, net of unamortized debt issuance costs of \$3.7 at June 30, 2017 (2016—\$4.0)	296.3	296.0
Euro term loan, net of unamortized debt issuance costs and discounts of \$1.1 at June 30, 2017 (2016—\$1.3)	89.9	82.5
Revolving credit facility	40.0	—
Debt payable to unconsolidated affiliate	40.0	39.5
Deferred payment obligation	—	30.0
Other borrowings(1)	40.1	40.7
Total debt	1,603.0	1,584.1
Less debt payable within one year	86.5	76.5
Debt payable after one year	\$1,516.5	\$ 1,507.6
Weighted average interest rates on total debt	4.6	% 4.6

(1) Represents borrowings under various lines of credit and other borrowings, primarily by non-U.S. subsidiaries. See Note 4 for a discussion of the fair value of Grace's debt.

The principal maturities of debt outstanding at June 30, 2017, were as follows:

	(In millions)
2017	\$ 82.4
2018	8.4
2019	7.8
2020	6.6
2021	1,191.7
Thereafter	306.1
Total debt	\$ 1,603.0





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## Notes to Consolidated Financial Statements (Continued)

## 3. Debt (Continued)

On February 3, 2017, Grace funded the PD trust with \$30.0 million in respect of the deferred payment obligation relating to ZAI PD Claims. (See Note 8.)

As of June 30, 2017, the available credit under the \$300 million revolving credit facility was reduced to \$222.3 million by a \$40.0 million outstanding draw and by outstanding letters of credit.

During the 2016 first quarter, in connection with the Separation, GCP distributed \$750 million to Grace. Grace used \$600 million of those funds to repay \$526.9 million of its U.S. dollar term loan and €67.3 million of its euro term loan. As a result, Grace recorded a loss on early extinguishment of debt of \$11.1 million, which is included in "other (income) expense, net" in the Consolidated Statements of Operations.

## 4. Fair Value Measurements and Risk

Certain of Grace's assets and liabilities are reported at fair value on a gross basis. ASC 820 "Fair Value Measurements and Disclosures" defines fair value as the value that would be received at the measurement date in the principal or "most advantageous" market. Grace uses principal market data, whenever available, to value assets and liabilities that are required to be reported at fair value.

Grace has identified the following financial assets and liabilities that are subject to the fair value analysis required by ASC 820:

**Fair Value of Debt and Other Financial Instruments** Debt payable is recorded at carrying value. Fair value is determined based on Level 2 inputs, including expected future cash flows (discounted at market interest rates), estimated current market prices and quotes from financial institutions.

At June 30, 2017, the carrying amounts and fair values of Grace's debt were as follows:

(In millions)	June 30, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
5.125% senior notes due 2021(1)	\$693.4	\$745.4	\$692.7	\$721.3
U.S. dollar term loan(2)	403.3	402.8	402.7	408.2
5.625% senior notes due 2024(1)	296.3	318.5	296.0	311.5
Euro term loan(2)	89.9	89.9	82.5	82.0
Other borrowings	120.1	120.1	110.2	110.2
Total debt	\$1,603.0	\$1,676.7	\$1,584.1	\$1,633.2

Carrying amounts are net of unamortized debt issuance costs of \$6.6 million and \$3.7 million as of June 30, 2017, (1) and \$7.3 million and \$4.0 million as of December 31, 2016, related to the 5.125% senior notes due 2021 and 5.625% senior notes due 2024, respectively.

Carrying amounts are net of unamortized debt issuance costs and discounts of \$5.1 million and \$1.1 million as of (2) June 30, 2017, and \$5.7 million and \$1.3 million as of December 31, 2016, related to the U.S. dollar term loan and euro term loan, respectively.

At June 30, 2017, the recorded values of other financial instruments such as cash equivalents and trade receivables and payables approximated their fair values, based on the short-term maturities and floating rate characteristics of these instruments.

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## Notes to Consolidated Financial Statements (Continued)

## 4. Fair Value Measurements and Risk (Continued)

**Currency Derivatives** Because Grace operates and/or sells to customers in over 60 countries and in 30 currencies, its results are exposed to fluctuations in currency exchange rates. Grace seeks to minimize exposure to these fluctuations by matching sales in volatile currencies with expenditures in the same currencies, but it is not always possible to do so. From time to time, Grace will use financial instruments such as currency forward contracts, options, swaps, or combinations thereof to reduce the risk of certain specific transactions. However, Grace does not have a policy of hedging all exposures, because management does not believe that such a level of hedging would be cost-effective. Forward contracts with maturities of not more than 12 months are used and designated as cash flow hedges of forecasted repayments of intercompany loans. The effective portion of gains and losses on these currency hedges is recorded in "accumulated other comprehensive income (loss)" and reclassified into "other (income) expense" when these derivatives mature.

The valuation of Grace's currency exchange rate forward contracts and swaps is determined using both a market approach and an income approach. Inputs used to value currency exchange rate forward contracts consist of: (1) spot rates, which are quoted by various financial institutions; (2) forward points, which are primarily affected by changes in interest rates; and (3) discount rates used to present value future cash flows, which are based on the London Interbank Offered Rate (LIBOR) curve or overnight indexed swap rates.

**Debt and Interest Rate Swap Agreements** Grace uses interest rate swaps designated as cash flow hedges to manage fluctuations in interest rates on variable rate debt. The effective portion of gains and losses on these interest rate cash flow hedges is recorded in "accumulated other comprehensive income (loss)" and reclassified into "interest expense and related financing costs" during the hedged interest period.

In connection with its emergence financing, Grace entered into an interest rate swap beginning on February 3, 2015, and maturing on February 3, 2020, fixing the LIBOR component of the interest on \$250 million of Grace's term debt at a rate of 2.393%. The valuation of this interest rate swap is determined using both a market approach and an income approach, using prevailing market interest rates and discount rates to present value future cash flows based on the forward LIBOR yield curves.

The following tables present the fair value hierarchy for financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2017, and December 31, 2016:

## Fair Value Measurements at June 30, 2017,

Using

(In millions)	Total	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
					\$	
<b>Assets</b>						
Currency derivatives	\$3.6	\$	—\$ 3.6	\$	—	
Total Assets	\$3.6	\$	—\$ 3.6	\$	—	
<b>Liabilities</b>						
Interest rate derivatives	\$5.1	\$	—\$ 5.1	\$	—	
Currency derivatives	11.6	—	11.6	—		

Total Liabilities      \$16.7    \$      —\$ 16.7    \$      —

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## Notes to Consolidated Financial Statements (Continued)

## 4. Fair Value Measurements and Risk (Continued)

(In millions)	Fair Value Measurements at December 31, 2016, Using			
	Quoted Prices in Active Markets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total for Identical Assets or Liabilities (Level 1)
<b>Assets</b>				
Currency derivatives	\$8.8	\$ —	\$ 8.8	\$ —
Total Assets	\$8.8	\$ —	\$ 8.8	\$ —
<b>Liabilities</b>				
Interest rate derivatives	\$6.0	\$ —	\$ 6.0	\$ —
Currency derivatives	0.9	—	0.9	—
Total Liabilities	\$6.9	\$ —	\$ 6.9	\$ —

The following tables present the location and fair values of derivative instruments included in the Consolidated Balance Sheets as of June 30, 2017, and December 31, 2016:

June 30, 2017 (In millions)	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under ASC 815:				
Currency contracts	Other current assets	\$ 3.0	Other current liabilities	\$ 0.4
Interest rate contracts	Other current assets	—	Other current liabilities	1.9
Currency contracts	Other assets	—	Other liabilities	10.5
Interest rate contracts	Other assets	—	Other liabilities	3.2
Derivatives not designated as hedging instruments under ASC 815:				
Currency contracts	Other current assets	0.6	Other current liabilities	0.7
Total derivatives		\$ 3.6		\$ 16.7
December 31, 2016 (In millions)	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under ASC 815:				
Currency contracts	Other current assets	\$ 4.0	Other current liabilities	\$ —

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Interest rate contracts	Other current assets	—	Other current liabilities	2.8
Currency contracts	Other assets	4.0	Other liabilities	—
Interest rate contracts	Other assets	—	Other liabilities	3.2
Derivatives not designated as hedging instruments under ASC 815:				
Currency contracts	Other current assets	0.8	Other current liabilities	0.9
Total derivatives		\$ 8.8		\$ 6.9

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## Notes to Consolidated Financial Statements (Continued)

## 4. Fair Value Measurements and Risk (Continued)

The following tables present the location and amount of gains and losses on derivative instruments included in the Consolidated Statements of Operations or, when applicable, gains and losses initially recognized in other comprehensive income (loss) ("OCI") for the three and six months ended June 30, 2017 and 2016:

Three Months Ended June 30, 2017 (In millions)	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from OCI into Income (Effective Portion)
Derivatives in ASC 815 cash flow hedging relationships:			
Interest rate contracts	\$ (1.1 )	Interest expense	\$ (0.8 )
Currency contracts	—	Other expense	(0.1 )
Total derivatives	\$ (1.1 )		\$ (0.9 )
Derivatives in ASC 815 cash flow hedging relationships:			
Six Months Ended June 30, 2017 (In millions)	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from OCI into Income (Effective Portion)
Derivatives in ASC 815 cash flow hedging relationships:			
Interest rate contracts	\$ (1.0 )	Interest expense	\$ (1.7 )
Currency contracts	(0.1 )	Other expense	(0.1 )
Total derivatives	\$		