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Tronox Holdings Plc (TROX)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Tronox Holdings' Second Quarter 2023 Earnings Call and Webcast. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. [Operator Instructions]

I would now like to turn the conference over to Jennifer Guenther, Chief Sustainability Officer and Head of Investor Relations and Financial Planning. Please go ahead.

Jennifer Guenther

Chief Sustainability Officer & Head-Investor Relations and Financial Planning, Tronox Holdings Plc

Thank you, and welcome to our second quarter 2023 conference call and webcast. Turning to slide 2, on our call today are John Romano and Jean-François Turgeon, Co-Chief Executive Officers; and John Srivisal, Senior Vice President and Chief Financial Officer. We will be using slides as we move through today's call. You can access the presentation on our website at investor.tronox.com.

Moving to slide 3. A friendly reminder that comments made on this call and the information provided in our presentation and on our website include certain statements that are forward-looking and subject to various risks and uncertainties, including, but not limited to, the specific factors summarized in our SEC filings. This information represents our best judgment based on what we know today. However, actual results may vary based on these risks and uncertainties.

The company undertakes no obligation to update or revise any forward-looking statements. During the conference call, we will refer to certain non-US GAAP financial terms that we use in the management of our business and believe are useful to investors in evaluating the company's performance. Reconciliations to their nearest US GAAP terms are provided in our earnings release and in the Appendix of the accompanying presentation. Additionally, please note that all financial comparisons made during the call are on a year-over-year basis unless otherwise noted.

Moving to slide 4, it is now my pleasure to turn the call over to John Romano. John?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thanks, Jennifer, and good morning, everyone. For those joining today who may be a bit newer to Tronox, we're the world's largest vertically-integrated TiO2 producer with sales in 2022 of $3.5 billion that were fairly evenly distributed across the Americas, Europe, Middle East and Africa and Asia Pacific. Our strategy is focusing on positioning Tronox as the advantaged global TiO2 leader to the production of safe, quality, low-cost sustainable tons.

More information on Tronox is available on the website. We've added a new video to the home page that does a great job of outlining the value that we bring to our customers through our vertically-integrated sustainable mining and upgrading solutions.

Now let's turn to slide 5 for a review of a few key messages for the quarter. Our solid second quarter performance was a result of continued market recovery from the first quarter and our ongoing discipline around costs. Tronox

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delivered adjusted EBITDA at the high end of our previously guided range and adjusted EBITDA margins above our expectations.

Additionally, as a result of the team's proactive approach to aligning the business with the current market conditions, we generated $81 million of free cash flow, above previously anticipated levels. Tronox results continue to demonstrate the strength and advantage of our vertical integration. These results would not be possible without the hard work and dedication of our global employees and we thank the team for their commitment to Tronox.

As an update on our operations at our Atlas mine in Australia, the primary roads are open, and we're currently utilizing them for hauling, which is allowing us to move more material and reduce inventory levels at the mine. Additionally, we published our 2022 Sustainability Report in the second quarter, outlining the targets that we've set for our business to become an increasingly sustainable operator in our ever-evolving world.

Turning to slide 6. I'll briefly review the sustainability-related targets we've set for Tronox. We are very focused on our sustainability efforts at Tronox, as this area is becoming an increasingly significant focal point and part of our conversations externally with investors, customers and other key stakeholders. Tronox has reinforced our previously disclosed path to carbon neutrality by 2050.

Additionally, we committed for the first time to targets to reduce Scope 3 emissions intensity by 9% by 2025 and 16% by 2030 against the 2021 baseline. We recommitted to our target of zero waste to external dedicated landfills by 2050, and we continue to prioritize safety and have also enhanced efforts internally to improve diversity within our organization. We are excited about the continued progress we make each year to become more fully aligned with the expectations of our key stakeholders. Please review our Sustainability Report, which is available on our website for more information.

Now let's move to slide 7 for a review of our second quarter financial performance in more detail. Revenue of $794 million improved 12% sequentially due to the improved sales volumes across all products. This represented a decline of 16% relative to the prior year due to continued market softness.

Income from operations was $84 million in the quarter. We reported a net loss in the quarter of $269 million, which included a $293 million valuation allowance in Australia relating to our deferred tax assets. Our normalized Q2 effective tax rate was 20%, adjusting for the valuation allowance and non-benefiting items and our adjusted diluted earnings per share was $0.16. Adjusted EBITDA in the quarter was $168 million and our adjusted EBITDA margin was 21.2%. Free cash flow in the quarter was $81 million.

Now let's turn to slide 8 for a review of our commercial performance. TiO2 revenues increased 9% versus the first quarter, driven by 9% increases in sales volume. TiO2 pricing was 1% lower compared to the first quarter, as expected, which was offset by a 1% tailwind from exchange rates. TiO2 pricing increased 1% compared to the year ago quarter.

We continue to deliver against our commercial strategy and realized relatively stable pricing trends despite volumes remaining well below seasonal normal levels. Zircon volumes increased 33% compared to the first quarter, representing a 21% decline year-over-year. Zircon pricing was lower by 1% compared to the prior quarter, which represented an increase of 7% year-on-year. Revenue from other products was $88 million, an increase of 35% to the prior year, largely driven by improved pig iron volumes and higher sales of rare earths, which increased 87% year-over-year.

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As a result of our unique portfolio, we are continuing to evaluate a range of options to leverage our expertise to further unlock the value of the rare earths generated from our operations. Our differentiated integrated position sets us apart as a global leader in sustainable mining and upgrading solutions.

Looking ahead, we expect pigment volumes to be relatively flat to the second quarter, as we expected our demand to remain higher than the trough levels seen in Q4 of 2022. While we previously anticipated volumes might continue to increase into the third quarter, the weak market conditions in China as well as broader Asia, Europe and the Middle East have brought our expectations down.

Our commercial strategy and differentiated offering have enabled more stable pricing trends than during previous years of demand decline. However, we do anticipate that the softer demand conditions will result in slightly lower TiO2 pricing in the third quarter compared to the second quarter.

On zircon, we do expect a more challenging second half of 2023 than we previously anticipated. At this time, based on our current market outlook, we expect zircon volumes for the third quarter to decline by 15,000 to 20,000 tons from the second quarter 2023 levels. Zircon is a critical mineral and a key part of our portfolio. Approximately half of the total zircon market is consumed in China, which is heavily influenced by housing market completions. Global supply demand for zircon will come back into balance when China recovers.

As quickly as the decline has impacted us on the downside, we will see the benefit of the upside when the market improves. We strongly believe in the strategy of being vertically integrated and the value that our zircon provides to our customers.

I'll now turn the call over to JF for a review of our operational performance. JF?

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Thank you, John, and good morning. Turning to slide 9, our adjusted EBITDA of $168 million represent a 39% decline year-on-year, driven by unfavorable fixed cost absorption due to lower production rate, lower sales volume and lower pig iron pricing, partially offset by favorable exchange rate and lower freight costs. Sequentially, adjusted EBITDA increased 15% due to higher product sales volume and exchange rate tailwinds, partially offset by lower average selling price and higher freight costs associated with higher volume.

We are continuing to run our operating site at reduced rate as a result of lower demand level in order to manage inventory and cash. As a result, the second quarter include $25 million of impact to EBITDA of lower cost to market and idle facility charge.

Looking to the third quarter, as a result of the market dynamics John previously outlined, we anticipate adjusted EBITDA for the third quarter 2023 to be $115 million to $135 million. This range includes $35 million of impact to EBITDA resulting from adjusting the production rate of both our pigment and mining site to better align with the latest market demand level and manage working capital and free cash flow.

Turning to slide 10. We will continue to balance the medium and long-term strategic need of the business to position Tronox for future success, while ensuring we are taking the right decision to manage what is within our control in the short term against the current macroeconomic landscape. This includes disciplined action to reduce

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costs. We have 380 different cost reduction initiative happening at all our different site around the world. We are optimizing our fixed costs and driving additional supply chain initiative.

We are prudently managing working capital. This quarter, we were able to release some of the working capital built in the first quarter as a result of our action. While our long-term strategic target is to be approximately 85% vertically integrated on feedstock as a result of current lower TiO2 production level, driven by customer demand, which was down 30% year-on-year in Q1 and 21% year-on-year in Q2, we are continuing to run our feedstock asset at lower rate. This result in slightly higher mining and upgrading costs in the second quarter, which will continue in the third quarter of the year.

On capital expenditure, as we have highlighted previously, we'll invest less than $275 million this year to adapt to the macroeconomic environment as it unfold by delaying investment primarily associated with volume growth not required in the short-term. While this will delay our ability to realize benefits from our key capital project, we do believe this is the appropriate decision for the business at this time and it's consistent with our ability to flex our capital spend.

We do believe it is important to continue to invest in the business throughout the cycle and we'll continue to proceed with the business-critical project that will contribute to future growth of the business. We will continue to balance cash generation while ensuring we have the product necessary to meet our customer need and are effectively positioning Tronox for future success.

Before I turn the call over, I want to briefly provide an update on Jazan. As we have disclosed in our filing, the original Jazan option agreement expired on May 10, 2023. We agree with Tasnee that until September 30, 2023, all chloride slag produced by the slagger will be delivered to Tronox as a repayment in-kind of the $125 million Tronox loaned to the project. The first shipment of chloride slag to reduce the loan balance is expected in the third quarter. Full repayment of the Tronox loan is required by January 2025 in either cash or in-kind through chloride slag delivery.

Tronox and Tasnee additionally agreed to extend the term of the technical service agreement to September 30 to enable Tronox' continue support to the Jazan smelter complex. We are currently conducting a value engineering exercise and we'll keep the market update on the statute of this assessment.

I would now like to turn the call over to John Srivisal for a review of our financial position. John?

D. John Srivisal

Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

Thank you, JF. Turning to slide 11. We ended the quarter with total debt of $2.7 billion. Our net leverage at the end of June was 3.8 times on a trailing 12-month basis. In the first quarter, we amended and extended our interest rate swaps such that approximately 76% of our interest rates are fixed through 2024 and approximately 67% are fixed from 2024 through 2028, aligning with the maturity of our term loan.

Our balance sheet remains strong with no near-term significant maturities until 2028 and no financial covenants on our term loans or bonds. Total available liquidity at June 30 was $447 million, including $167 million in cash and cash equivalents, which is well distributed across our global operations. Capital expenditures totaled $55 million in the quarter. Approximately 60% of this was for maintenance and safety capital and 40% was for strategic growth projects. Depreciation and amortization expense was $68 million for the quarter.

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As John mentioned earlier, our free cash flow was $81 million. This is above our expectations, primarily due to the team's proactive approach in aligning the business with current market conditions. We returned $50 million to shareholders in the form of dividends. We paid both the first and second quarter dividends equivalent to $0.50 per share on an annualized basis in the second quarter.

Moving to slide 12. Based on the current view that John and JF outlined, we anticipate third quarter adjusted EBITDA to be $115 million to $135 million. Pivoting to our expectations for our 2023 cash uses, our working capital assumptions increased to a use of approximately $150 million to $175 million due to softer market demand than previously anticipated. Our net cash interest expense assumption remains unchanged at $130 million. Our expectations for cash taxes were lower to approximately $40 million and our expectations for capital expenditures remain unchanged at less than $275 million for the year.

We will continue to assess and execute against the levers we can pull to ensure sufficient liquidity and continued alignment of our production and costs to respond to the economic environment we are operating in. We remain focused on delivering on our commitments.

That concludes our prepared remarks. With that, I'd like to turn over the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of David Begleiter from Deutsche Bank. Please go ahead.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Good morning and thank you. John, you had mentioned some pricing pressure in TiO2. Can you talk a little bit more about how much that pricing pressure is and where it's coming from by region?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. Thanks, David. So we don't predict – typically provide breakdown by region, but what we can say is that as we saw in the last quarter in Middle East, Latin America, we are seeing a little bit more pricing activity and we're competing [ph] – while (00:18:01) we're competing a little bit more heavily with the Chinese. I'd say, globally, when we think about that reduction in Q2 to Q3, we're talking about 2% to 3%. And again, a significant portion of that movement is in areas like Asia, Latin America and Middle East.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Very good. And just on zircon, how long do you expect this downturn, this destock to persist?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. Look, it's a great question. I think we've provided some color previously around what our position is in China. So zircon, as we mentioned in the prepared comments, is about 50% of the market. And historically, we were aligned with that when the market – when we sold down inventory, when the market picked up significantly,

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we repositioned a lot of what we were doing. So our sales into China is only about 35% of our total selling of zircon at this stage compared to 50%.

That being said, in the second quarter, we were selling pretty much everything we were making and we were restricted by what we could produce and that's when we talked about the Atlas transition moving into the third quarter. So what's happened in China has happened relatively quickly. And I would say, over the course of the last 30 days, we just finished the quarter and we had a pretty strong quarter on zircon. So it's happened relatively quickly. We do not believe, there's a significant amount of inventory in the chain right now, call it, 45 to 60 days depending upon the region.

And because there – what we're seeing in China, although China has not been strong for the last 2 quarters, we have seen it start to turn down. It didn't pick up after Chinese New Year. It didn't pick up after the opening from COVID. And I would say it's worse than what we would expect. And so we are now seeing some of the zircon that would have been sold in China moving into other markets. So even though our position in China is not as significant as it was, China move – zircon moves around a little bit more freely than we would say TiO2 does.

So short answer to your question is, we would expect that there's not much inventory in there. And as our customers start to get a better feel for what's happening in the market, we should start to see a return in the volume in the fourth quarter. July was a very low month. We're already seeing the August and September order pickup, but the range that we gave in that 15,000 to 20,000 tons assumed that we'd see a pickup in July and August, I mean – excuse me, August and September. And we would expect that we'd start to see that same kind of – a similar rebound moving into the fourth quarter, but the recovery is largely going to be dependent on what happens in China, how quickly that market recovers. And that's something that we're just not really in control of.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Josh Spector from UBS. Please go ahead.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah. Hi. Thanks. So just within TiO2 and the charge you're taking this quarter from the lower op rate, the $35 million, just curious how we should think about that on a go-forward basis. I know some of it's bringing down your inventory levels, but if operating rates stay at this level, is that $35 million charge something we should be extrapolating another quarter or two beyond 3Q until we see volumes really pick up? And what's the threshold to consider? Thanks.

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. Thanks, Josh. If you take a look, we did say that we were going to be burdened this – in Q3 by $35 million, primarily due to fixed cost leverage, as we brought down our production. We do expect to see that. And we have been operating most of the year at less than 70% of our capacity and expect to continue that for the rest of the year. So we would expect a similar amount in Q4. Obviously, we have significant leverage in our business. As volumes increase, we will bring back production and expect that $35 million charge to go away pretty quickly once the market recovers.

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John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And when we think about the market recovery, again, we called the bottom in the fourth quarter. We saw a 14% increase in the first quarter, 9% increase in the second quarter, which was below what we initially anticipated, and that recovery is just not coming back as strong. So when we think about third quarter bonds, we referenced flattish. As we think about the fourth quarter, where you would normally see some sort of a – maybe a seasonal downturn because we are lower levels than what we would have historically been, we don't expect the fourth quarter at this particular stage to see much of a seasonal downturn from Q3.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And Josh, I'd like to add that, I mean, the drop in TiO2, as John mentioned, running our plant at less than 70% capacity, we had to adjust our mine and upgrading facility as well and we have lower production on that side of the business. So it's a double impact for us. But as soon as there is a recovery, it will have a double positive impact on our costs.

Joshua Spector
Analyst, UBS Securities LLC

Q

Understood. No, I appreciate that. And just going back to the earlier question around pricing and where you're talking about there's more pressure, I guess, how do we think about the pressure of Chinese TiO2 in those markets and what that means for market share? So you're holding pricing better than maybe the market in total, but do you have any view on if you're losing some incremental share and therefore, the recovery maybe comes back to a lower than – lower levels versus the prior couple of years?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Well, thanks, Josh. And again, we just mentioned the numbers on our – maybe pick up from the fourth quarter. So, again, 14% increase in the first quarter, a 9% increase in the second quarter. And if you look at exports of TiO2, which were high last year, they're up 10% if you look at the last year-to-date. So 10% year-to-date compared to the year-to-date previously.

So they're not growing at the rate that they were. What I would also say is that most of the Chinese suppliers, we believe, almost all of them, are operating at a loss right now. Recently, as recently as this week, we've seen China increasing TiO2 pricing, both inside of China and on the export market, and we do believe that's going to stick. There's – anecdotally, we're hearing some other issues about the high temperatures in China, which are causing plants to have to actually slow down to manage energy consumption. So there are a lot of things that are happening that we believe could lend itself to China starting to pull back.

So short answer is, are we losing some market share in less strategic areas? The answer is probably yes. But we're managing our business to ensure that we're also continuing to compete. Now, when we talk about small price reductions, like 2% to 3%, the price gap between Chinese material and Western TiO2 is significantly different than that. So we're making some small adjustments, but our customers are also seeing us for other things other than just price. They appreciate our regional footprint. They appreciate a lot of what we're doing on the ESG effort. And we're spending more and more time as we clearly identify what we're doing on our Scope 1 and Scope 2, as our customers are looking at Scope 3, we're starting to become a lot more valuable and pricing is not the only thing that our customers are looking at us when we think about our strategic value to them.

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Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Yeah. And we're in a downturn. So, obviously, customer has choice, but they know how it's important as thing will turn up to have a reliable supplier. And I think that our vertical integrated position is a key advantage in that regard.

Joshua Spector
Analyst, UBS Securities LLC
Q

Okay. Thank you, all.

Operator: Thank you. Your next question comes from the line of Duffy Fischer from Goldman Sachs. Please go ahead.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Yes. Good morning. If you look at your volume on a two-year stack over the last three quarters, it's down 34%, 36% and 31%. Clearly, your customers, paint and plastics folks, aren't down anywhere near that much. When you look at your sell-in versus their sell-out, how much longer do you think you can continue to be significantly more negative than your end customers?

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

It's a difficult question, Duffy. I think that John kind of explained it with what's happening in China. Look, the Chinese have built capacity and increased export in a market that is not growing. I mean, our customer have obviously not dropped in volume as much as we did, but the Chinese has continued to increase their market share at that time, and they're doing it at no profit. In fact, they're doing it as a loss. I mean, it's clear that they're kind of subsidized, and more specifically, the government-owned entity in China.

Look, ore has not moved down. So their cost structure is just wrong. And I think that even the best player like LB in China have a margin that is lower than Tronox at the moment. So we don't see that as sustaining, and we continue to work on our cost to be a more stronger competitor, and we have prepared our business for a rebound because we believe that will happen.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

And I think it's a great question, because we don't think it can last very much longer. I mean the reality is a lot of our customers, which you hear reports from, are talking about they're not holding – destocking is complete. Some of our customers are even talking about building inventory in the fourth quarter in preparation for coating season next year. So it's a valid point. A lot of that was attached to destocking. We talk about China. We talk about the recovery. We can't control when the market recovers. We can control what we do to manage the business between now and then. We definitely believe we're well beyond midpoint of a downturn and an upturn is coming. It's just a little bit – China, I think, is creating a little bit more uncertainty on when that might happen. But it's a great point, and we don't think that can continue much longer.

And when you think about, again, the two-year stack, we don't typically look at it that way, but we look at it sequentially. Moving into the third quarter kind of with what we talk about on flat pricing, we should be down 9-ish

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to 10% compared to the prior year quarter, which is, again, not great, but it's a significant improvement from where we were in the first quarter and a significant improvement from where we were in the second quarter.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Fair enough. And then two other areas that you haven't talked about price, but that are seeing weakness. One is zircon and the second is – and JF, you just kind of mentioned at the ore side, both high-grade and low-grade ilmenite. With the weakness we're seeing in volume, should we expect to see pricing in those three products start to wane?

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

So, Duffy, I'll cover the ore and I'll let John talk about zircon. But on the ore side, look, starting with ilmenite, ilmenite price has been very stable. I mean, they have stopped increase, but they haven't moved down. And that's true worldwide. And look, obviously, ilmenite is used to make high-grade feedstock, like slag, and we haven't seen slag price going down. In fact, slag price has continued to slightly creep up. And same thing with natural rutile. Natural rutile has been very stable.

So I think this reflects the fact that, remember, only a year ago, we were talking about a shortage of raw material and nobody has invest to develop new mine and significantly increase. So I think it's a market that, look, obviously, because of the slowdown in TiO2 at the moment, there is enough feedstock. But as soon as the market will turn, I think that that's where you will see the advantage of a company like Tronox that own its own mine, have invest recently in new mine and continue to invest in the mining side of the business and that will differentiate ourselves from the competition, but very stable price on that side of the business.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Yeah. And then on zircon. So zircon, there's a lot of moving parts on that. The biggest shortfall for us in the quarter is going to be the volume. There has been some movement. We had a 1% drop in price that we referenced Q2 – or Q1 to Q2 and a lot of that was attached to probably the lower end, I'd say, quality of the zircon that we sell. We refer to that as [ph] zirco (00:31:50) as opposed to high grade.

So we have seen some movement. The pricing has not been significant. There has been some mix. And again, a lot of that – I think that's one of the reasons that the market kind of slowed down so much. When China slowed down, you saw a lot of what historically – for instance, there's about 60,000 to 70,000 tons of zircon that comes out of Indonesia typically goes into China. When China slowed down, you started to see that inventory start getting quoting into India. So there's some assumptions out there that I think are driving this drop off in volume that are associated with what our customers might think happens in the market.

So not a lot of movement on price. The biggest issue on zircon is the volume. It's one of our higher-margin products. And again, as I said on the prepared comments, it dropped off quickly. And as China recovers, we believe it'll pick back up quickly.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Great. Thank you, guys.

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Operator: Thank you. Your next question comes from the line of John McNulty from BMO Capital Markets. Please go ahead.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Good morning. Just a question on how to think about cash flows as we progress through the year. I think there was certainly some hope, you'd start to unlock some working capital and drive some greater free cash flow. I guess, given the further pullback in your operations, is that something that we should see as kind of a good counterbalance where the EBITDA is off, but the cash flows accelerate or is that not the case? I guess how should we be thinking about that as the year progresses?

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. John, thanks for the question and – but your assertion is correct. I mean, we are taking significant action in light of this market environment and we brought down production pretty significantly to help drive cash. Additionally, we do have a lot of cost initiatives as well that we will help drive improvement throughout the rest of the year. But generally speaking, we do think there's a logical chance – a realistic chance that we can claw back the significant cash use that we've had in the first quarter. Obviously, the first quarter, although a significant use was as we expected, the second quarter was above our expectations. And you can see that was clearly driven by actions that we actively took and we intend to do that in Q3 and Q4.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Okay.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And from a cash flow perspective, although it's not – it hasn't impacted tremendously in the third quarter yet, we're starting to see the impacts of raw materials starting to move down. So not only raw materials, we're seeing freight move down, container freight, bulk freight. So we're starting to see a lot of the things that were headwinds for us that although we've got a long way to go, will start to be a tailwind. And we would expect that to start to impact us in the third quarter and will start to get more momentum in the fourth quarter.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Okay. So just to be clear, do you think working capital will be a use or source of funds this full year, like – or full 2023?

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. I mean we've guided working capital for the full year is negative $150 million to negative $175 million.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Okay. [indiscernible] (00:35:06)

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D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

As you know, the biggest use was in Q1. So taking Q1 and Q2, net-net, the rest of the year, it's flat to slightly positive [indiscernible] (00:35:15).

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And the inventory that we were building in TiO2, which we've slowed down on, I mean, JF made reference to, we are also adjusting mines, but we're still mining. We're still mining heavy mineral concentrate. So the zircon drop-off will also allow us to build some inventory, which, quite frankly, could be a positive as the market returns because as I mentioned before, in the fourth quarter – I mean, the second quarter, which was only two months ago, we were selling everything that we can make.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. And John, you would remember that we talked about $150 million of cash use earlier in the year. We have increased that number to $175 million. And that's linked to zircon.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Okay, got it. Fair enough. And then maybe just as a follow-up, the TiO2 industry has had much better pricing resiliency than we've seen in downturns, especially ones of this magnitude, which I think was believed that it would actually end -or lend stability in general to the industry. But with the Chinese producers running at rates that are actually losing money, I guess, does it make you rethink the pricing strategy that you have for your TiO2 business going forward, if you're going to have this level of lapse in discipline from major producers in the industry? I guess, how would you answer that?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

I think the answer is no. We would stick with this pricing strategy that we had. It's ultimately designed to help us weather downturn. This downturn is more significant than we would have expected it to be, more significant than what we talked about at Investor Day. But at the end of the day, it's not just the Chinese suppliers that are losing money, it's pretty well known there are other suppliers out there that are going through restructuring.

So the industry is in a bad place. Our margins are still significantly better and we do believe that we are in a better position to make it through this than some others. So I think there's an element of the loss-making of this industry is going to be – the governor of that is going to be how much balance sheet that people have to manage that. And so that's why we think when you start to see some of these, I would say, aggressive moves that we're not necessarily responding to, as I mentioned, our pricing reductions, we targeted – we indicated that 2% to 3% in the quarter. Those aren't significant moves, but they're moves that we need to make sure that we're keeping what we need when we think about strategic share.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Very clear. Thanks very much.

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Operator: Thank you. Your next question comes from the line of Mike Leithead from Barclays. Please go ahead.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning, guys. First question, I want to go back to working capital sort of getting back to John's question just now. I think last quarter, you thought it would be a use of $150 million. Now you're taking actions, rightfully so, to reduce production rates to work down inventories, yet your working capital use of cash is going higher. I would have thought it would have gone lower. So why is that?

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. Thanks, Mike, for the clarification question. And you're right. I mean, we did end up guiding last quarter $150 million and kept the bottom end of that range and then [ph] range it (00:38:51) up about $25 million. Part of the thing that's driving that change is what JF mentioned, is the zircon inventory increase. So while we are bringing down pigment production and we do see volume-wise, pigment is going down across the year, we are burdened a little bit there from higher cost. So overall dollar value of inventory is going up, and combined with the zircon ton increase. As you know, we are slowing our mines down a bit, but we still are building zircon inventory. So that's really driving that band. If we do end up selling more zircon than we expect, obviously, we will be able to lower the – to the lower part of our range.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And when John – yeah, I think it's another point on that. John referenced, we've been running at slightly below 70% on capacity utilization. Our plan, when we reported last, was we'd be ramping up production because we were expecting to see a higher third quarter. So there's an element of that inventory costing that's just based on where we're running today versus what we might have anticipated, we were going to be running three months ago.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: Thank you. Your next question comes from the line of Frank Mitsch from Fermium Research. Please go ahead.

Aziza Gazieva
Analyst, Fermium Research LLC

Q

Great. Thank you. Good morning, guys. It's Aziza on for Frank. So my first question, I think John Romano included a comment on rare earths in the prepared remarks. Can you elaborate on the long-term strategy in that arena?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. Thanks, Aziza. Look, it's something, as I mentioned in the prepared comments, that we're continuing to look at. It's something where we feel as a mining and upgrading company, we're uniquely positioned to do that. The monocyte that we had historically been, I'd say, stockpiling as a waste has now turned into a revenue stream

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and that revenue continues to generate. So when we start to think about how we develop that, we've got a plan on what we're doing, and we mentioned that we're going to let that – we're going to let the revenue come from that [ph] B.V. (00:40:59) investment in the initial stages. So it'll be self-funding. But as we think about moving even between now and the end of the year, there's opportunities that we're looking at that will allow us to continue to expand that and we'll probably be in a better position maybe in the third quarter call to give you more clarity around that, but it's absolutely something that we believe could be a core part of our business, and we're taking steps – I'd say, measured steps to ease our way into that so that we're self-funding it for right now. But it's an exciting part of our business. And I can tell you there's a tremendous amount of our people that are engaged and looking at opportunities on how we can expand that.

Aziza Gazieva
Analyst, Fermium Research LLC

Q

Got it. Thank you. And how should we be thinking about the expected lingering impact from the flooding in Australia as they flow through 3Q and 4Q P&L? And on the Atlas project, are you still expecting it to contribute $70 million or more in a normal year?

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yes. The answer to that is the flood is gone and everything is back to normal. Look, the unfortunate reality is with what's happening with the zircon market, we would be in a very good position to supply at the moment, but the market has kind of dried out. But as soon as the market recover, and with zircon, I mean, I can tell you, 30 days ago, everything was fine. We had no issue. That it's in July that we had this huge drop. It can turn up the same way as quickly. And we'll be in a very good position, as mentioned by John, we'll have built inventory of zircon and our mine will be ready to operate and produce to meet that market demand.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And when you think about the roads being open, now we're able to move that material from Atlas to Broken Hill so that we can upgrade it, so it's – and it's ready to ship at zircon. So not to say we wouldn't have gotten any benefit in the third quarter. We would have, but those roads opening allow us to build that inventory in a position where we can ship it in the fourth quarter. So it's definitely having a drag on the third quarter, but if the market does come back, which we – we're not saying it's going to come back completely, but we do believe it's going to bounce off the bottom and we should start to see that inventory being consumed in the fourth quarter.

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

And Aziza, to your question, we do see, once we're back up to normal, the outlets will give us additional $70 million benefit for the year, $70 million to $90 million.

Aziza Gazieva
Analyst, Fermium Research LLC

Q

Okay. Thank you, guys.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Thank you.

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Aziza Gazieva
Analyst, Fermium Research LLC

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Matthew DeYoe from Bank of America. Please go ahead.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

Morning, everyone. So, there's the $70 million to $90 million benefit you just said, but obviously, there's the lower – the headwinds from just the lower mine operating rates in general. So if we were to move to 2024 and volumes aren't down 30%, they're down – maybe they're up or they're down 10% or whatever, whatever it takes to get operating rates back at the mine to full rate, I mean, how much of a tailwind is that, if you think about just full rate operating at the mine sites and then moving Atlas back to full rates? Like, what monetarily should we expect comes back to the company?

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

So, Matthew, I'll try to help. Look, obviously, it all depend, I would say, but it has a huge drag on the $35 million that we mentioned of running at low rate on the mining site. And the reason is simple, mining are high fixed cost operation. And when you talk of mining, you're more at 60%, 70% fixed cost. So, unfortunately, as you slow down, you're not saving as much. With the pigment plant, we have developed, what I call, flexibility in our operation and we're able to turn them down with less impact. Look, obviously, there's a limit to what you can do, but – and being below 70% is not a great place to be. But I'd say that in 2024, we're convinced that that $35 million of downturn, we could probably recover all of it.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

[ph] The quoted number as well (00:46:00).

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. It's, yeah.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

And from an operational perspective, I mean, that mine is ready to go. Atlas is running. This is just a matter of now having a market to support all the additional volume.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

I understand. And the $35 million is helpful, particularly for the context of this quarter, but production costs have been about $100 million headwind for the last two quarters. I think presumably a fair amount of that is just from other mine operating rates being below. So I'm just trying to contextualize a more normal operating rate environment.

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D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. I mean when we quote the $35 million, it really relates to the fixed cost leverage of bringing our production down. We absolutely have seen headwinds in costs, but we are seeing that, as John mentioned, tail off towards the end of this year. So we view it as, obviously, 35% is separate from direct material costs, but it would be even more should we return back to normal levels. And as we've said before, direct materials, setting the context from 2020 to today to 2022, was up $400 million year-over-year. So we do see a potential to claw back and get closer to those levels. We're only seeing – we had quoted last quarter that we would see 2022 to 2023 being 2% to 3% down in direct materials, excluding ore. As John mentioned, we're seeing more of that as the year progresses, more of it in Q4. If you look at overall year-to-year, we now expect it to be roughly down 4%. So continues to make progress on it. So as you mentioned, $35 million is good from a fixed cost leverage. And if we see further cost decline, it'll be above the $35 million per quarter.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. Just maybe a little bit more color on the raws. We've talked about chlorine a lot over the course of the last, I'd say, four quarters. The chlorine market in the US is starting to soften. And that's going to translate into prices coming down from record high levels and we're well positioned contractually to take advantage of that downturn as early as this quarter. So we would see chlorine as an opportunity. And I'd say our procurement team has done a really good job of establishing some strategic relationships, which will put us in a better position on that in the future as well.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

Okay. And then if I can, price was up year-over-year across both segments, but I think price is a $4 million headwind to EBITDA. Is that just mix or what's driving that?

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Primarily pig iron price.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

All right. Understood.

Operator: Thank you.

Matthew DeYoe
Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: Your next question comes from the line of John Roberts from Credit Suisse. Please go ahead.

John Roberts
Analyst, Credit Suisse Securities (USA) LLC

Q

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Thank you. I just have one. What's the rate in dollars at which Jazan can send you chloride slag?

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Well, John, I mean, as you can imagine, we're not going to give that type of details. But when we compare Jazan, I mean, we would like that operation to be producing at a similar cost than what we are producing in South Africa. And at the moment, I think that with only one furnace running and running at 50% of its original capacity, it's not meeting the level that we were expecting. And that's why the option agreement just lapsed.

Look, at the moment, the furnace is running and it's still producing slag. And it's obviously a Tasnee asset and they work with their supplier of technology to try to see how that could be improved. And meanwhile, Tasnee has agreed to supply that slag to us to pay back the loan. And look, it's like the commercial agreement that we had in the previous year. We're paying market price for that slag.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

As opposed to paying cash [ph] for it, it's going against debt (00:50:13).

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc
A

Yeah. And as we've mentioned before that assuming Jazan operates as it has historically, we expect that loan to be paid back, assuming they apply all this slag to it sometime about a year plus from now.

John Roberts
Analyst, Credit Suisse Securities (USA) LLC
Q

Thank you.

Operator: Thank you. Your next question comes from the line of Jeff Zekauskas from JPMorgan. Please go ahead.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Thanks very much. Your TiO2 demand was down or your volumes were down, whatever it was, 22%. If you look at your end markets, plastics, paper and coatings, were the demand decreases different or were they the same in the quarter as best as you can tell?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Yeah, Jeff, I'd say we saw more of, I'd say, a downturn on the plastics segment than we did on coatings. That being said, we're heavily weighted on coatings. About 79% of our volume goes into coatings and that's broken down into a variety of different applications in coatings. So paper and specialty, which is even smaller than plastics, was down as well. So a lot of paper and specialty is actually in Asia Pacific and in the European market where we saw that drop earlier.

So short answer is, I'd say, coatings has held up maybe a bit better than plastics and paper laminate and specialty, but there is not a huge swing either direction. I'd say, directionally, they're all down, but what was

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probably the worst was the plastics segment. And we're starting to see a little bit of at least, I'd say, green shoots of customer demand picking back up again on the plastics, although it's from a low level.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

So when you look at your coatings customers, is the way you think about it is that their end market demand is flat to down and their inventories are 20% too high. order of magnitude, and we're going to go through a period. And then depending on whether they build inventory next year or things stay pretty flat, that's the way TiO2 demand will go. Is that your conceptualization or is it something different?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Well, I think what you said, absolutely related to what was going on in Q3 and Q4. So last year, that destocking event was what's – what we were thinking actually did happen. So we started to see pick up. Our customers are starting to order again. So we've talked about the bottom in the fourth quarter. We had 14% growth in the first quarter, 9% growth, which was not quite what we expected. So it's not as if it's getting worse in the third quarter. It just hasn't rebounded. So I do not believe nor does JF believe that we have a significant amount of destocking to complete now. This is the market. And as the market rebounds, to the extent there is a coating season, and next year, and people start building inventory, as I said, we've heard some customers talking about building inventory in the fourth quarter, we'll start to see the volumes move. But a lot of that's going to be driven by macroeconomic activity, which we can't control our influence.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. Jeff, year-over-year, in Q3 of this year, we expect an improvement versus – well, versus the drop that we had in Q2. I mean Q1 was 30% down...

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

...Q2 was 20% down and Q3 will be 10% down versus 2022. So when we call the bottom, that was Q4 2022, on TiO2, that's still how we believe the market is playing. It's really the zircon in Q3 of this year that is a surprise to us at a time where we had gear up to increase zircon sales with our mine. Unfortunately, the market is not there. But, look, we'll be ready for when it turns.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

So you have a certain amount of optimism around zircon. I mean, zircon pricing was under $2,000 a ton from 2012 through 2020. And then zircon prices spiked beginning in 2021, and I don't know, maybe they got all the way up to like $3,500 a ton and now maybe we're something like 22%. Like, why can't we go from $2,200 a ton to $1,500 a ton? Like, what is it about the zircon market that makes prices more stable now than they've been historically?

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John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Yeah. So the $3,500 number, which, I guess, was regularly out there on Bloomberg, was more of the spot market, so we didn't have a lot of spot market volume in that number.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Yeah.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

So call it...

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Whatever it was, yeah.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Yeah, in the $2,000 range. I think it all comes back down to supply. So when the market rebounded in 2021 and 2022, we sold 100,000 tons – or actually 2021, we sold 100,000 tons more than we produced. We adjusted our footprint. That's how we made these adjustments to have a lower exposure into China. And there hasn't been a lot of additional capacity added.

So up until the second quarter, as we mentioned, we were selling pretty much everything that we were making, and now China slows down. And that's why if 50% of the market's in China, you've now got prices at a point where they are higher than they would have been historically. We didn't say prices weren't going to move, but we said we don't expect a lot of volatility in that area. And the reason that we saw the significant drop off in July is because I think customers are thinking just what you're thinking, and that is the market's changing, I'm going to hold off. There's not that much inventory in the system. We believe there's maybe 30 to 60 days of inventory, depending upon the customer and the area that we're selling into. So there's not a tremendous amount of time for customers to wait before they start repurchasing again. And that's why although we're not saying the market's going to rebound in the fourth quarter to where it was, we think it's – July was definitely a bottom. I mean it was a very low number, and that was – we believe a lot of that was speculation on what was going to happen.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

So have zircon spot prices begun to rise or are they still falling?

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Well, I will tell you, as recently as three months ago, spot prices were starting to move back up. Indonesia started raising their price again, and Indonesia is a good indicator for what's happening in the spot market. And now, they are – I would say, they've stalled out a bit, because of what's happening in China with, I would say, no rebound at all and with 50% of the demand there, and call it, a significant portion of that that's tied to housing finishes, a lot is going to depend on how quickly China recovers. And there's things out there, but China is talking about more

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stimulus. I'm not sure how they're going to continue to put stimulus into housing and infrastructure, but they're talking about that. So that could stimulate some growth in this area.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

Same thing in the rest of the world, Jeff, I think that – we think that the bottom on new construction is over. And as things will improve, I think that the zircon is a key essential material for those construction to happen. So I think that we're not worried that there is a huge inventory in the pipeline.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc
A

And everywhere else that we sell has – again, we were selling what we were producing up until the second quarter. And Europe, North America, Latin America, Asia Pacific were already depressed. So the real driver [ph] ex was ex was (00:58:21) China in this most recent downturn.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Okay. Thank you very much.

Operator: Thank you. Your next question comes from the line of Roger Spitz from Bank of America. Please go ahead.

Roger Spitz
Analyst, BofA Securities, Inc.
Q

Thank you very much. If the impact of the unabsorbed fixed costs in Q3 is going to be about $35 million to EBITDA, can you provide the numbers for Q1 and Q2, please?

Jennifer Guenther
Chief Sustainability Officer & Head-Investor Relations and Financial Planning, Tronox Holdings Plc
A

Roger, we laid out, for Q2, it was $25 million approximately and a similar level for Q1, excluding the impacts of the Atlas and the KZN.

Roger Spitz
Analyst, BofA Securities, Inc.
Q

Got it. I missed that. Sorry. And then, otherwise, pigment volumes have been increasing substantially sequentially, 14% and 9% that you've mentioned. So – and you've been running your pigment plants at lower rates to manage inventory. You spoke about 70%, although maybe that was for the entire system. So, I mean, is this because you had a large pigment inventory at December 31 that you can absorb this increase in pigment volume sequentially, but you're still having to run at low rates? And if that is the case, how should we think about 2023 EBITDA of $8.75, which presumably would have benefited from overproduction or a benefit from better fixed cost absorption?

Jennifer Guenther
Chief Sustainability Officer & Head-Investor Relations and Financial Planning, Tronox Holdings Plc
A

So Roger, recall, what we said in the fourth quarter was that we were going to bring down our operating rates to align more closely with the market, but we didn't bring it down to align with that 35% year-on-year decline because

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that level we did not believe was sustainable and we've been right about that. Q4 was a trough and we've seen TiO2 rebound from there. So we've expected a continued step-up in pigment tons from that level. So we've always been working to balance the replenishment of some of our inventory at year-end, which was needed, because we were well below safety stocks earlier in 2022 and then also planning for the expected demand to come.

As we mentioned, the second quarter saw a 9% increase versus what we had previously thought might be the high – mid to high teens percent increase. So now instead of increasing the operating rates, as we previously anticipated, we're keeping them lower and so managing that inventory. So it's all a trade-off between looking at our cash, inventory build and short-term impacts to EBITDA. But again, these are just charges that we're incurring in the short term. We believe it's the right decision to manage and generate higher cash and the leverage of our business will be significant when we ramp back up our operations. We'll see savings from the projects we've been investing in. We'll see the margin improvement, and all of that will come back quickly as we bring the assets back up.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

When we think about where our inventory is now, it's above seasonal norms. But that's another reason why we were expecting a bigger uptick in the third quarter than we're seeing. So we talked about flattish. So we maintained our volumes at the same production level that we had in the second quarter. And when we start thinking about if there is a build in the first quarter, I mean, in the fourth quarter for the first quarter coating season, we'll still have enough inventory where we can meet that uptick if there is one. And when we see that pick up, we would then start pulling production back up.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Thank you very much.

Operator: Thank you. Your next question comes from the line of Hassan Ahmed from Alembic Global. Please go ahead.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Morning, John and Jeff. I wanted to revisit the $35 million charge you guys are talking about for Q3. I don't know whether you'd be able to sort of parse it out for me because, obviously, you guys are talking about flat sequential TiO2 volumes. So obviously, production isn't going down over there. So to me, obviously, that hit is primarily from the mining operations. And then you're obviously guiding to 15,000 to 20,000 tons of lower zircon volumes. And I understand that's a high-volume – a high-margin business for you guys. And if I were to sort of run my numbers based on some estimates, I'd like to think that that 15,000 to 20,000 ton reduction in zircon volumes may be around a $20 million hit to EBITDA. So I'm just trying to understand the different components of that $35 million.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Well, the $20 million that you referenced on zircon is not part of the $35 million anyway. So the $35 million – let's just talk about fixed cost absorption on the TiO2 side. Again, we were anticipating moving into Q3 that we would see a pickup. We also thought that Q2 was going to be more like 14% – 13%, 14% as opposed to 9%. So the assumptions that we had were that we were going to increase production as we saw demand increasing and we

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didn't see it to that level. So John referenced this 70%-ish kind of capacity utilization, which at this particular stage, we will probably continue to run at through Q3, which is having an impact on fixed cost absorption for TiO2. John, do you want to add?

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. No, that's exactly right. And when you ask about – our range of $115 million to $135 million, the range was primarily related to zircon volumes.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Understood. And as a follow-up, where do you guys stand now? Obviously, market conditions sort of having moved the way they have and we're all sort of obviously learning of the impacts. But in terms of just you guys' view of the trough earnings power of the company. I mean it just seems that every quarter, the rain sort of keeps getting more volatile, right? I mean, if I were to go by your $115 million to $135 million Q3 guidance, that would imply annualized $460 million to $540 million. If I were to sort of credit it for that $35 million hit that you guys are giving, on an annualized basis, that would imply $600 million to $680 million in sort of "trough EBITDA". So where do you guys stand with your views around the trough?

D. John Srivisal
Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

A

Yeah. I don't think, Hassan, we've changed our view on where we think trough EBITDA is going to be. As you know, if you start on this year, we did have and go through a couple of one-off challenges primarily relating to Atlas and KZN that is lowering the base of where we're starting from. But as you also know, and we've chatted about this entire call, we are up against market dynamics that are unprecedented from our view and that we don't have a lot of control over. We did think that more demand would materialize from China, which it hasn't. And that's a big driver of both our TiO2 and zircon performance and outlook for the rest of the year. We don't think it's going to stay depressed from these levels. And we do think we are past, as John mentioned, the midpoint of the cycle, and we'll expect to crawl out of them where we are today.

John D. Romano
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. I think the short answer is we do not believe where we are today is a multiplier by four to come to an annualized number. And the reality is this is, in fact, a much deeper recession. And we use the recession word downturn, pick the word you want to use. We believe the TiO2 industry leads in and out of one. We believe we're in one and we're much further – or much closer to a recovery. So we still believe in the long-term dynamics of this business. So the points that were brought up on this call around, the reality is our customers have managed their inventories down. TiO2 has not been displaced at the rates that – our sales have been displaced. It's not a permanent thing, and we do believe the market's going to recover.

The zircon piece, which was quick, to John's point, is the one that probably for this quarter was the most significant one and the one that turned the quickest. And as recently as June, the market was looking – was much stronger than it is in July is, for sure, the bottom with regards to our – what we're seeing on demand.

Jean-François Turgeon
Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

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Yeah. And Hassan, I'd like to finish on a positive note that would add to that, and it's the rare earth. I mean this is a business that is growing very fast. The demand for rare earth material is very strong and will be very strong with the electrification of the world, and Tronox is well positioned to become a key player on that space. And that would also help be a bit countercyclical to our TiO2 and zircon business.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

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Very helpful. Thank you so much.

Operator: Thank you. There are no further questions at this time. I would now like to turn the call back over to Mr. JF, Co-Chief Executive Officer, for any closing remarks.

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thank you, Laura, and thank you for joining the call, everyone. Our key priority for 2023 remain unchanged. We will maintain a relentless focus on sustainability and safety; continue to align production with customer demand and prudently reduce cost accordingly; manage our key capital project without losing sight of the long-term benefit to Tronox, including reducing our cost per ton and managing working capital and free cash flow in the current market environment.

That conclude our call. Have a great day. Thank you.

Operator: Thank you, sir. Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.

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