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Tronox Holdings Plc (TROX)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Tronox Holdings' Q3 2023 Earnings Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. [Operator Instructions] This call is being recorded on Thursday, October 26, 2023.

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 third 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, 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. 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. On slide 4, we've included an introductory overview of Tronox as a reference for anyone who may be newer to our story. For more information, please visit our website, we also have a video on our 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.

Before turning the call over for our first (sic) [third] (02:48) quarter highlights, I want to briefly comment on the situation in the Middle East. While our exposure is minimal, our hearts go out to those impacted by the conflict, and we offer our support to those who are affected.

Now, let's turn to slide 5 to review a few key messages from the quarter. We delivered the third quarter performance within expectation despite softer market conditions by maintaining an unrelenting focus on managing

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what is within our control. Q3 saw relatively modest pricing declines across both TiO2 and Zircon, as expected, despite depressed market volumes. This is a direct result of Tronox's differentiated offering and the value customers place on Tronox as a supplier.

TiO2 volumes improved sequentially in the Americas, while volumes were sequentially weaker in other regions, most prominently in the Europe, Middle East and Africa. This contributed to an overall weaker TiO2 demand environment in Q3 than anticipated. Zircon sales volumes recovered in August and September from the low levels seen in July as anticipated and communicated on our last earnings call. While overall market demand levels remain muted, we are confident that the July represents the trough as inventory levels are relatively normal throughout the supply chain.

On the operational front, we're continuing to prudently manage utilizing rates at our pigment, mining and upgrading sites as a result of lower customer demand to reduce inventory levels and generate cash. At our Botlek TiO2 facility, we experienced a supplier outage that resulted in our plant being taken offline in September. We have been working closely with our supplier and believe the plant will be restarted by November 11. Importantly, this has not disrupted our ability to fulfill customer demand as we had sufficient inventories on hand due to our ability to reposition product from other facilities as a benefit of our global asset footprint. We have, however, incurred incremental charges from an expected downtime due to unabsorbed fixed cost and idle facilities charges. And we'll provide further details on that a little later in the call.

Our finished goods inventory decreased in the quarter, driven primarily by lower pigment inventory, partially offset by higher zircon inventories as Atlas ramped up against a backdrop of softer market demand. Additionally, in the third quarter, we bolstered the balance sheet by proactively raising a $350 million incremental term loan, the proceeds of which were used to enhance available liquidity and will enable us to prepare for critical vertical integration capital expenditures in 2024. This is a demonstration of our commitment to balancing the medium and long-term strategic needs of the business to position Tronox for future success while ensuring we're making the right decisions to manage what is within our control in the short term against the current macroeconomic landscape. Our performance quarter after quarter is made possible by our Tronox team to whom we extend our thanks and for their dedication and commitment.

On slide 6, we'll review a few updates on some of our key sustainability initiatives. First, the solar project in South Africa with South African independent power producer, SOLA Group continues to progress and construction remains on track to be completed in December of 2023. Delivery of first power is expected April 1 of 2024. This is an incredibly impactful project for Tronox and our progress toward reducing our carbon emissions.

Running at full power, we'll convert approximately 40% of our electricity to solar power in South Africa and is expected to reduce our global emissions intensity by 13% against our 2019 baseline. Renewable power projects remain the highest return, highest impact opportunities and progressing towards our stated greenhouse gas emissions reduction targets. We are exploring green energy opportunities at all of our sites around the world.

We are also progressing in other areas of sustainability as well, including reducing waste to external landfills. Our R&D teams are currently exploring alternative uses for waste in a number of opportunities, including cement, road base, bricks and water treatment chemicals. Additionally, we're continuing to evaluate opportunities to extract valuable minerals and metals from waste, including rare earths, scandium and vanadium. We firmly believe that these initiatives and many others ongoing at Tronox will continue to be key in not only preserving our privilege to operate, but differentiating Tronox for key stakeholders. We look forward to continue updating you on our journey.

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Now let's move to slide 7 for a review of the second (sic) [third] (07:23) quarter financial performance in more detail. Revenue of $662 million declined 17% sequentially due to lower pricing and sales volume across all products. This represented a decline of 26% relative to the prior year due to continued market softness. Income from operations was $32 million in the quarter and we have reported a net loss in the quarter of $14 million.

Our normalized Q3 effective tax rate was 14%, adjusting for non-benefiting items and our adjusted diluted loss per share was $0.08. Adjusted EBITDA for the quarter was $116 million and our adjusted EBITDA margin was 17.5%. Free cash flow in the quarter was a use of $37 million.

Now let's move to slide 8 for a review of our commercial performance. TiO2 revenue decreased 9% versus the second quarter, driven by a 5% decrease in sales volume and a 4% decrease in average selling prices. TiO2's sales volumes declined 14% compared to a year ago quarter while average selling prices decreased 5%, partially offset by a 2% tailwind from favorable exchange rates. The modest decline in TiO2 pricing relative to volume levels continues to prove Tronox' differentiated position and the success of our commercial strategy.

Zircon volumes decreased 61% compared to the second quarter, representing a 71% decline year-over-year due to significant market softness experienced in July. As a result, zircon pricing was lower by 4% compared to the prior quarter, which represented a decrease of 3% year-over-year.

Revenue from other products was $71 million, a decrease of 24% to the prior year, largely driven by lower pig iron pricing and volumes. This was partially offset by higher sales of rare earths, which improved 27% year-over-year. As a result of our unique portfolio, we are currently evaluating a range of options to leverage our expertise to further unlock the value of the rare earths generated from our mining operations in South Africa and Australia. Our differentiated, integrated position sets us apart as a global leader in sustainable mining and operating solutions.

Looking ahead to the fourth quarter, we expect pigment volumes to be relatively flat compared to the third quarter. This represents an approximate 20% increase compared to trough levels realized in the fourth quarter of 2022. We anticipate little to no seasonality in the fourth quarter as we believe customers have largely completed destocking. We do believe that we will see some restocking in the fourth quarter as customers prepare for 2024, which is reducing some of the seasonality impact. We expect that more stable pricing trends over the last year compared to the previous years of demand decline will continue.

On Zircon, we expect volumes to continue to recover substantially from the third quarter of 2023 trough levels. We strongly believe in our strategy of being vertically integrated in 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

Thank you, John, and good morning. Turning to slide 9, our adjusted EBITDA of $116 million represented a 53% decline year-on-year, driven by lower sales volume, lower product pricing and unfavorable fixed cost absorption due to lower production rate. This was partially offset by favorable exchange rate tailwind, lower freight costs, and lower corporate costs.

Sequentially, adjusted EBITDA decreased 31% due to lower product sales volume, lower average selling price, and unfavorable fixed cost absorption due to lower production rate. This was partially offset by lower freight costs, favorable exchange rate tailwind, and lower corporate costs.

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As John mentioned, we are continuing to run our operating side at a reduced rate as a result of lower demand level in order to manage inventory and cash. As a result, year-over-year production costs increase of $43 million includes $30 million of higher cost associated with lower absorption and higher input costs and $13 million of lower cost or market and idle facility charge due to lower production rate.

Looking to the fourth quarter, as a result of the market dynamic John previously outlined, we anticipate adjusted EBITDA to be $105 million to $125 million. 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 include disciplined action to reduce costs, optimizing our fixed costs, and driving additional supply chain initiative. We are prudently managing working capital. This quarter we reduced pigment inventory, though we built feedstock in zircon inventory. As a reminder, our mining and upgrading asset have higher fixed cost than our pigment site. So while we have reduced production level as a result of current market demand, we are balancing running at optimal rate and we will as a result, build some inventory.

While our long-term strategic target is to be approximately 85% vertically integrated on feedstock as a result of the current lower TiO2 production level driven by customer demand, which was down 30% year-on-year in Q1, 21% year-on-year in Q2, and 14% year-on-year in Q3, we are continuing to run our pigment asset at lower rate. This has resulted in higher costs this year, which will continue in the fourth quarter.

On capital expenditure, as we have highlighted previously, we will invest approximately $270 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 the benefit from our key capital project, we do believe this is the appropriate decision for the business at this time and is consistent with our ability to flex our capital spend. 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.

I want to briefly provide our latest comment on [indiscernible] 00:15:13 As we had disclosed in our filing, the original [indiscernible] 00:15:20 option agreement expire on May 10, 2023. We extended our agreement with Tasnee such that until November 1, 2023, all chloride slag produced by the Slagger will be delivered to Tronox as repayment in kind of the $125 million Tronox loan to the project. We received shipment of the chloride slag which reduced the loan balance and the related accrued interest by $27 million 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 November 1 to enable Tronox continue support to the Jazan smelter complex while negotiations are going on. We will keep the market update on the status.

Before I turn the call over, I would like to provide a few word on yesterday's announcement of my upcoming retirement. I'm extremely honored to have played a part in Tronox transformation over the last 10 years. I strongly believe the company has never been better positioned to continue navigating the current environment and generate meaningful value for shareholders. I look forward to the future ahead for Tronox and I wish John the best as he take over, having absolute confidence he is the right choice to continue to lead the company.

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I would like to thank the board, John, and my colleagues for an incredible journey at Tronox. It is the effort of all of our employees that make Tronox what it is today, and with John's vision and leadership, this will continue to evolve for the better.

I will now 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 and congratulations. We are all grateful for the invaluable contributions you've made to Tronox.

Turning to slide 1, we ended the quarter with total debt of $2.8 billion and net debt of $2.6 billion. Our net leverage at the end of September was 4.8 times on a trailing 12-month basis. The incremental term loan of $350 million raised in the third quarter reinforces the strength of our balance sheet and bolstered available liquidity ahead of anticipated critical vertical integration related capital expenditures in 2024. This transaction increased total available liquidity by approximately $350 million, while net leverage remained net neutral as we used the proceeds to pay down outstanding borrowings on our revolving credit facilities with the remaining going to cash. Our near-term significant maturities remain 2028 and we have no financial covenants on our term loans or bonds. We maintained interest rate swaps such that approximately 73% of our interest rates are fixed through 2024, and approximately 64% are fixed from 2024 through 2028, aligning with the maturity of our term loans.

Total available liquidity as of September 30 was $726 million, including $246 million in cash and cash equivalents, which is well distributed across our global operations. Capital expenditures totaled $54 million in the quarter. Approximately 55% of this was for maintenance and safety, and 45% was for strategic growth projects. Depreciation, depletion, and amortization expense was $67 million for the quarter.

As John mentioned earlier, our free cash flow was a use of $37 million. We reduced our pigment inventory levels in the quarter. Offsetting this benefit was increased feedstock levels due to lower pigment plant production as well as higher zircon inventories as outlets ramped up against a backdrop of softer market demand. We returned $19 million to shareholders in the form of dividends.

Moving to slide 12. Based on our current view that John and JF outlined, we anticipate fourth quarter adjusted EBITDA to be $105 million to $125 million. Pivoting to our expectations for our 2023 cash uses, our working capital assumption increased to a use of approximately $185 million. While we are continuing to actively manage working capital, including continuing to reduce pigment inventories through year-end, the increase is a result of the softer market conditions driving higher-than-expected Zircon inventory levels.

Our net cash interest expense is expected to be $125 million, our cash taxes are expected to be approximately $40 million, and our capital expenditures are expected to be approximately $270 million for the year. We remain focused on delivering on our commitments.

I will now turn the call back over to John Romano for a few closing comments before we get to questions. John?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thanks, John. I wanted to also congratulate JF on his upcoming retirement and thank him for being an extremely valuable partner and a force of positive change in our company over many years. It's been an honor to serve in this role as Co-CEO together with him, and especially with someone for whom I hold an immense amount of

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respect. I'm excited about the future for Tronox, and I'm confident there will be a smooth transition over the next six months.

And with that, we'd like to turn the call over to questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Duffy Fischer at Goldman Sachs. Please go ahead. Your line is open.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Good morning, guys. Just a question on your expectations going into the fourth quarter. It seems like you guys are more bullish on volumes for both TiO2 and zircon. I think most others have kind of commented they see things continuing to be down. Can you just walk through, what underscores your belief that volumes will be flat, what are you seeing in the market for both zircon and TiO2, please?

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

A

Yeah. Yeah. Thanks, Duffy. So on TiO2, we said relatively flat. And part of that has to do with we've – the market is already – has been significantly down for the last eight quarters we've seen volumes down, and we called the bottom in the fourth quarter of 2022, and we've continually seen that uptick. We do believe that all the destocking has run its course. And when we look at our order book for the fourth quarter, that reference to little-to-no seasonal demand. We're seeing some areas, in areas like Asia Pacific where our volumes are actually up in the fourth quarter. So is that because the market has recovered significantly? No. Part of it is just because customers are starting to order again.

So, we feel pretty confident in where we are at this stage. We're a third of the way through the quarter. We've got good visibility in where our order book is at this particular stage. I mean, there is a range that we provided. But at this particular stage, on the volume side of the equation, we are continuing to see things move in the right direction, as we move into first quarter next year, we'll provide more guidance on 2024. But we're cautiously optimistic that we're moving in the right direction for a recovery on TiO2.

On zircon, the third quarter was the lowest quarter we've had in many, many years. And when we think about where we are, we called the bottom in July. We saw our volumes pick up significantly in August and September. And so, when we look at the fourth quarter, based on our forward order book, our volumes are expected to be up over the third quarter by more than 50%. So, we're coming from a very low base, but those volumes are up and we feel confident what those numbers are looking like in the fourth quarter at this stage. So, I hope that answered your question.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

No, that is helpful. Thank you. And then on the comment, did I get that right? Working capital is going to eat $185 million in cash this year. And if that's right, what do we need to see next year for that to be released?

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

Yeah. And Duffy that's correct. We are guiding $185 million use for the full year. Obviously, we do expect Q4 to be a generator of cash. If you count through LTM the first nine months of the year we're roughly at the $218 million use. So we won't have a benefit for the fourth quarter. We do see – we have managed our inventory down pretty well. So we brought down production levels. But frankly, the driver here on inventory, as we mentioned, is the zircon market. So, continue to produce. Obviously, we're running our mines. Zircon is a product that comes out of it, so we're building inventory roughly $50 million build in the second half of the year that's driving that.

So, as we look towards 2024, we do expect to be – working capital to be a use, obviously, or sorry, expect working capital to be a source of cash for 2024. As we do expect, as John mentioned, we do expect the market to recover. So, we do expect to sell the inventory, draw that down and generate significant amount of cash.

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

And, Duffy, I would add, we obviously, it's zircon, but it's also high grade feedstock because we have slowed down our mine, but we have not slowed them down as much as our pigment plant. And because of that, we have built some feedstock.

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

That's right. Obviously, we brought down pigment production, but we're not using the feedstock. So, that's building this year as well.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Great. Thank you, guys.

Operator: Thank you. Our next question comes from the line of David Begleiter of Deutsche Bank. Please go ahead. Your line is open.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you. Good morning. Just going back to the Q4 volume expectations in TiO2, how good is your visibility? And you mentioned some potential restocking. How confident are you in that occurring either in Q4 or Q1?

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

Well, look, we've provided guidance for Q4. And again, based on our forward order book at this particular stage and what we're seeing in the month of October which is largely past, we're seeing some of that rebuild happening. And again, it's not happening in every region. So, that rebuild is having an impact or dampening effect on what we would normally see as seasonal demand downturn. So, in a normal year and again, you got to go back a while to find a normal year, but you can say high single digits kind of decrease in demand in the fourth quarter for seasonal adjustments, we're seeing nothing in that range. So, a lot of it has to do with customers having destocked significantly and having to start rebuild some of the inventory. So, I'd say in some areas, it's going back to normal buying patterns which they have not been on for more than three quarters.

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

A

And John, [ph] we can have that, (27:24) obviously, Q3 was a very low volume quarter. So, that's why being flattish for Q4 is, it's not a great quarter.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Understood. That's helpful. And just on the CapEx for last year, can you talk to the increase and is there any potential for further delays if the macro remains or even gets more challenging from here? Thank you.

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

A

Look, maybe I can cover that. Look, we obviously wanted to be in a good position to continue to invest in our vertical integration. And we had a couple of projects in our mine in South Africa that will create a lot of value. And when we talk investing in mine, you're talking of project that would take a couple of years to realize, but then they have 10 year of benefit to the company and we will obviously adjust that capital requirement based on what we will see the economy of the world do. We always said we have some flexibility with our capital, but there is some good project that will add value to the business that we consider doing at the moment based on what we're seeing.

I mean, we expect 2024 to be better than 2023. I mean, we called the downturn for TiO2 in Q4 2022 and we still commit that that was the case and the downturn for zircon was in Q3 this year. And we're seeing things improving and we expect 2024 that will continue to improve for zircon as well.

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

A

I mean, if there was some sort of unforeseen event, a war escalated somewhere, we needed to make adjustment. We do have flexibility on that $350 million and we would adjust accordingly.

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

A

Yeah. And we've obviously guided $270 million for this year, and as John mentioned, we expect to be in the mid-300s next year, not the levels that we had in 2022. But we do have flexibility even in that $350 million number.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Very good. Thank you.

Operator: Thank you. Our next question comes from the line Josh Spector at UBS. Please go ahead. Your line is open.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah. Hey, guys. Thanks for taking my question. And first off, thanks JF, for all the contributions over the years and congrats, John. So I wanted to ask on the fourth quarter guidance, not on volumes, but on the EBITDA side.

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So if you see a 50% uptick in zircon, my math is that that kind of gets me to the top end of your guidance alone. So just wondering within the other puts and takes outside of [ph] TiO2 (30:05) volumes, is there something else you're assuming on price or is there some additional roll through of cost because of the idle facility charges that ramps in the fourth quarter? And how would that progress into early next year?

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

A

Yeah. I think the key drivers of the range for our Q4 EBITDA guide is primarily commercial. So you're right, Josh, that obviously pricing is going to play a part of it outside of the zircon volumes. A big driver there also is, as we've mentioned earlier, we did have an outage at Botlek due to our supplier next door and that's really a driver as well. It's $5 million in Q3. And so just depending on – we expect it to get up in November 11, in a couple days now, a couple of weeks now. But that may create some further burden depending on when it gets up.

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

A

Yeah, that's a third-party provider of steam, which we need to actually finish the pigment there. So we believe we have confidence in what they have been telling us on coming up on November the 11. But that's definitely something that could create some sort of variance in that number.

Joshua Spector
Analyst, UBS Securities LLC

Q

Okay. Thanks. And just kind of looking into early next year, not necessarily anything volumes or price related, but more the cost side, I guess, with how you're operating your mines. I guess I just want to understand that you guys kind of changed how you operated mid this year. You're taking more charges now. As we look at you plan into next year, does that burden increase or decrease on your EBITDA as we think about the first half next year versus second half this year?

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

A

Yeah. I think one of the things we – a question that came earlier about working capital, the other issue that's impacting working capital is also the cost of our inventory. So, our costs have definitely gone up, and it takes a little bit of time to work that through. So we're still going to see – we're going to be burdened with higher costs from the inventory that we have in the system, as we make that high-grade feedstock that ultimately goes into our TiO2 production. So, it will take a little bit of time for that to work its way through the system. John, do you want to...

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

A

No. That's exactly the answer.

Joshua Spector
Analyst, UBS Securities LLC

Q

Got it. All right. Thanks, guys.

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

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John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Thanks for taking my question. Maybe just a follow-up to Joshua's call. So if – I think you said earlier that 3Q had about a $38 million hit tied to higher fixed cost absorption, and it seems like that's something that's going to continue to drag on. To your point, you've got high cost inventory to work through. Is this something that, based on the higher inventory levels that you have on the ore front that can drag through most of 2024, or is that too Draconian in terms of how we think about kind of the pressures that that high-cost inventory and high fixed cost absorbed inventory works its way through the system? I guess how should we be kind of gauging that as we look to next year?

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

A

Yeah. Yeah, John, good question. And I'd say you'd be – at [ph] three (33:17) year-end, we'd expect that cost to flow off in our results within the first four to five months of next year.

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

A

And it's not just feedstock, John, either. It's, we've been pretty open about how we're running our assets on the TiO2 side at 70% capacity utilization. So as we start to see the market picking up, we'll start to ramp those plants back up and that fixed cost absorption from those finishing facilities will start to come down. And quite frankly, there are some assets that we're already starting to move up in response to some of the things that we're seeing, but we're still running those assets well below full capacity.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Okay. That's helpful. And then maybe just a little bit of color. I think you had mentioned in one of the responses just that you were actually starting to see some demand pull in Asia, and it's probably not demand driven, it's more restock it sounded like. But I guess do you have clarity or do you have much comfort in where inventory levels are in Asia or any of the major regions, and how much below normal they may be at this point? Is there a way to kind of give us a little bit of color around that?

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

A

Well, I think the simplest thing is that from our salespeople and the engagement that we have out with our customers, they do get out and have very – a lot of dialogue with customers around where inventory is. I think at the end of the day, there's still pricing activity going on out there. And when we start to pull back from requests to reduce price and customers continue ordering at the same levels, that gives you an idea that, you're towards the end of what typically tends to be a downturn. So it's our belief that customer destocking has run its course. Orders are picking up. I mean, even in China, we're seeing orders picking up. That's not because China has rebounded significantly, it's because our inventories and the inventories inside the industry there have gotten to a level that's not sustainable.

So I think there's an element. I mean, India, for instance. India is still a very strong market for us. That's an area where there's a significant amount of Chinese exports that go into India but our volumes into India are continuing to be strong and it's one of the bright spots.

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John McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Okay. Thanks for the color and JF, congratulations, and enjoy the retirement for sure.

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

A

Thank you, John.

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

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Hey, good morning. And, yeah, let me echo my congratulations to you, JF, been a pleasure working with you and of course, looking forward to working with you, John, in your new role. I'd like to come back to price. You indicated that, that the pricing weakness that you saw year-over-year and sequentially was mainly in Asia and Latin America. I was wondering if you could give a little more color on the pricing in North America, in Europe, and what your expectations are for the balance of the year in TiO2?

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

A

Yeah. Thanks, Frank. So, we don't typically have a lot of detail and color on regional pricing, but what you said is accurate. And we saw a lot of, a lot more movement on pricing activity in Asia-Pacific and the Middle East and even in Europe. Now, there's been, what I would say, a fair amount of competitive activity, and, in certain areas where people are still struggling to try to pick up volume and we haven't been responding to those what I would call spot requests for price reduction on offers that we don't think are reasonable.

So, the pricing is still, I'd say, moving in different regions. North America, it's nice that we haven't seen any price erosion. There has been some, but it's been more stable than most regions. And in Asia-Pacific, I would say we've seen most of the down cycle movement on pricing. And not to say that it's going to start moving up. But in this particular environment, in China specifically, we have seen what we believe to be the bottom on pricing and we have a facility there that we're now operating at a higher rate because we're seeing stronger demand. And you've heard about price increases coming out in China. And we have had some of the implementation of those price increases in China. So, again, it's hard for us to actually pinpoint exactly when we'll see the complete bottom on price erosion and when we'll start to – when that inflection point is on the upside. But we feel pretty confident about what we said on the call. And that is this stability that we've seen considering the volume environment that we're in, we would expect that to continue moving into 2024.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Okay. Got you. That's very helpful. And then I like to come back to zircon. Obviously, volumes in July were very much the story, and I believe you indicated on the last call you anticipated your zircon volumes to be down 15,000 to 20,000 KT or 15,000 to 20,000 tons. And I was wondering, where did that actually come in? And can you revisit the air pocket that you saw in demand in July. How anomalous is that? How concerned are you about hitting another one of these air pockets as we progress through this year into next year?

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

A

Yes. And so, Frank, I would say that was anomalous, so we don't expect that to recur. You had a significant downturn in China that basically nothing was rebounding there. There's a significant amount of zircon that's consumed there. And there was an inflection point where customers started to think that they could actually get price reduction so they just stopped buying, and that was July. And we said that we would expect to see that pick back up in August and September. 10,000 to 15,000 tons that we projected to be down, we were down a bit more than that. But what we've seen as we move into the fourth quarter into October and in November, as I mentioned, the volumes are up significantly from that low in 3Q or the third quarter and we were expecting volumes to be up more than 50% from that third quarter number.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Okay. Great. Thank you, John.

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

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. Thank you. Good morning. Just one for me. I wanted to go back to the cash and inventory discussion. I appreciate everything you've said about focus on managing working capital. But just when I look at the numbers, Tronox's dollar amount of inventory has gone up for eight consecutive quarters now, whereas most all chemical companies are generating cash this year from working capital. So, why is that not the case for Tronox? Or maybe why are you not pulling back production rates even more to generate faster cash?

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

A

Thanks for that question. I think it's twofold. Obviously, while we have reduced our pigment production down, which is driving a significant generator of cash, our mining as well, we've slowed as well. But as I mentioned earlier, zircon is building. So, it was about $25 million in the quarter. As I mentioned earlier, it's about $50 million increase for the second half of the year. I think part of what you're seeing as well is our input costs continue to remain very high. So, it's significantly elevated from about two years ago. I think we've quoted historically, it's over $400 million increase from 2020 to 2022. So, that's part of the reason why we aren't seeing – while reduction in total volume is down, pricing still remains pretty elevated.

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

A

Not dissimilar to, our price. Some people have said it's a bit stickier than it was before. It's been similar on the raw materials, but we're starting to gain some traction off of that. So, we're starting to see those raw material prices move down. We would expect, as we go through the fourth quarter and the first quarter of next year, we'll continue to see benefits from that.

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

A

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And as JF mentioned as well, the feedstock is a big component of the increase. So, we do slow down our production plants, but we are vertically integrated. So, we are running our mines and building that feedstock inventory.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

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

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Good morning, John and JF. JF, first of all, best of luck, wishing you all the best for your retirement. My question, first question is around your margins, EBITDA margins. I mean, obviously, the margin squeeze has been pretty extreme, 17.5% in Q3 of 2023, down from 21.2% in Q2 and 27.6% same period last year. So, my question really is, I mean, I'd imagine, part of the margin squeeze is the fixed cost absorption side of things, lower zircon pricing, and the like. But, you guys always talk about the virtue of integration. You guys are obviously the most integrated guys out there. I'm just trying to get a better sense of what the cost curves are looking like right now, right? I mean, if you guys have seen this sort of a margin squeeze and are reporting 17.5% EBITDA margins, I'd like to think a large chunk of your global competitors are maybe even below breakeven levels, right? I mean how should we be thinking about that as it pertains to, call it, pricing on a go-forward basis?

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

A

It's a great – thanks for the question, Hassan. It's a great question. 17.5% EBITDA margins for us is we've been talking about being in the 20s for a long period of time. Part of ours was in fact due to zircon coming down significantly more than we thought it would but there's no question I mean there's companies that are in the restructuring process right now. We've stated on our last three calls that we believe that most of the Chinese producers are not making any money.

So, you started that inflection point on pricing moving in the other direction, and you've got exports coming out of China in the 1.5 million to 1.6 million tons on a trailing 12-month basis. And customers can only absorb so much of that even with that price difference, so I think that there's absolutely a point in time where pricing needs to go in the other direction or the profitability of the industry is going to get to the point where people start closing down assets.

And again, I think that's where we are at this particular stage. There's not a lot of room. Fixed, when we talk about the high grade feedstock, pricing hasn't moved much on that. Ilmenite prices has remained north of $400 a ton. So with input costs like that there's got to be an inflection point at some point in time.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

[ph] Very, very said. (44:44) And just sort of carrying on with that thought on the input side, input cost side of things, look, I mean there is some skittishness around sort of call it chlorine pricing. There is, with housing doing what it's doing and the like, I mean there is a school of thought that chlorine pricing may come down on a go-forward basis. And similarly I mean like you said ore pricing through this entire downturn has held up quite well.

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But again one hears more and more about there being ample supply of ore. So, as you think about, beyond Q4, call it, how do you think the input cost side of things will shake out broadly for the industry, and specifically for you guys? Because obviously that's going to play a role in your sort of integrated margins on a go forward basis as well.

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

A

Well, Hassan, maybe I'll start by your second point on the ore holding. Look, I think that there was a good response by the producer. I think that the, I mean, we have a big producer in Australia that has announced shutting down its production asset for the whole Q4. You have the biggest producer in the industry that has furnace down and that's in the public domain. We have said that we have adjust our production as well.

So, so all of the key raw material producer have adjust to that slow demand market. So, and that's, I think that's why the price has hold stable for feedstock, on the supply.

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

A

And maybe just a little bit on the input cost, you made reference to chlorine right, that one has gotten a lot of publicity for many quarters. And our procurement team did a really good job of creating some opportunities for us to try to leverage an opportunity to get lower pricing. We made reference on the last call that we were going to see a price decrease in the third quarter. It's pretty public that chlorine prices have started to move. Caustic prices have started to move. So, that's what we talked about. With regards to chlorine, we would expect to continue to see some opportunity there.

And then on other raws, John made reference that we hadn't seen as much down – a downward movement on pricing on our raw materials that we had expected, and we're – but we're starting to see that moving into the end of this year and into the first quarter next year as we're starting those negotiations for 2024 contracts.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Very helpful. Thank you so much, guys.

Operator: Thank you. Our next question comes from the line of Vincent Andrews at Morgan Stanley. Please go ahead. Your line is open.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC

Q

Hi. This is Turner Hinrichs on for Vincent. I was wondering if you can provide some additional color on the supplier outage as it relates to building a bridge from your 3Q to your 4Q expectations. Will you be able to continue serving customer demand fully out of inventory? And does it imply any additional logistical or other costs that we should consider when building the bridge?

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

A

Yeah. Look, so from the standpoint of being able to continue to supply customers, we made reference that we had inventory in place. We also have a footprint that allows us to move inventory around to make sure we can

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meet that demand. So at this particular stage, based on the November 11 startup that we talked about, we don't expect to miss any orders. There will be some additional cost attached to moving that material around. John mentioned the reality is there will be an opportunity for an insurance claim. And we won't see that in the numbers probably until 2024. But all those additional costs that are attached to that outage at Botlek will be factored into that.

And at this particular stage, I mentioned during the call or at some point in the Q&A that we were also ramping up some of our plants to make sure that we had inventory to meet the needs should there be any further downturn on that. But at this particular stage, based on what we're hearing from our supplier, we still feel pretty comfortable that November the 11 start date for Botlek is firm.

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

We have mentioned Q3 was burdened by the $5 million from the Botlek outage since we're up pretty early in the month around mid of the month, you expect that to only be a couple of million burden in October.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thanks so much for that color. Another one, do you mind providing some additional color to level set our expectations for underlying demand and the macro by region, as well as what you're seeing for TiO2 export trends?

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

Yeah. So on the export trends for TiO2 out of China, we saw a tick-up in the month of September. I made reference that on a trailing 12-month, it's about 1.5 million to 1.6 million tons. That number was positive. It was an increase because you had a couple of months that fell off that trailing 12 month that were very low. But we continue to compete with the Chinese in areas where we select to. There are some instances where we made some reference that we had to make some adjustments on pricing to maintain some, what we would define some strategic share in Latin America and the Middle East. But we're not expecting any significant change in exports at this particular stage.

As far as demand regionally, we don't typically provide specifics on, a breakdown on where we're seeing growth by region. I will make the comment that in the fourth quarter, we made reference that we see little-to-no seasonality, in some instances, we're seeing volumes specifically in Asia Pacific and even in the Middle East, where volumes are up Q3 to Q4, and that's largely driven to destocking or running its course and customers needing to make refill their inventory.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Yeah. Okay. Thank you. Congrats to both JF and John as well.

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

Thank you.

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

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Producer price index has peaked in the – maybe in November 2022 and producer price indexes have been dropping since that time. Has that made any difference to your TiO2 pricing? Is that one of the factors that's pressuring them lower?

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

A

Thanks, Jeff. PPI indexes don't have anything to do with any of our contracts. Maybe some of our competitors out there have had some PPI indexes that had an impact on their pricing or might be tied to contracts. But we don't use PPI as an indicator on TiO2 for any specific tied to pricing. Not to say that it hasn't had any impact. It's others are using PPI indexes that could have had an impact on where – what they're doing, which could drive competitive behavior. Hope that answered your question.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah. Thank you. You talked about having to meet prices of Chinese competitors. Is that in chloride-based titanium dioxide or sulfate based TiO2 or both?

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

A

It's predominantly on the sulfate side in China. And, the gap between the sulfate and the chloride has been significant. So, when we say make some adjustments to maintain strategic share, it doesn't mean we're meeting sulfate pricing on Chinese. It means that we had to be more competitive to prevent customers not migrating more of their volume away from the chloride TiO2 to the sulfate. So, specific to sulfate and chloride not meeting it, just having to make some adjustments to narrow the gap.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Is China more competitive in chloride now?

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

A

I think over time, China, they've got – Lomon has gotten more competitive, their grades are more competitive, we've heard they've had some quality issues here recently. So, I think the short answer to your question is, over time, the quality of the chloride material has gotten better. And in certain areas we're competing with Lomon Billions specifically on a head-to-head basis. But it's, yeah, I think there's an element of our customers not wanting to have all of their eggs in the Chinese basket. And that's why there's a limitation to what we believe they can do to substitute Chinese material for Western material.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you very much.

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Operator: Thank you. [Operator Instructions] The next question comes from the line of Roger Spitz at Bank of America. Please go ahead. Your line is [indiscernible] (54:01)

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Thanks very much. Good morning. I know you don't want to give numbers on this, but maybe can just talk generally about your European TiO2 pigment EBITDA in Q3 versus Q2. Can you talk about how much, how that changed? How much it changed? You don't have to put numbers on it, but you could talk just in generalities.

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

A

Yeah, I think just generally speaking in Europe, Q2 to Q3 costs are up, so it's, we're seeing the, some of the burden of that.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Got it.

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

A

We don't ever provide breakdowns by region on EBITDA.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Sure. Sure. So, the free cash flow guidance, OCF less CapEx that you've given that implies negative [ph] 75 (54:55) for the full year. Is that, am I looking at that correctly?

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

A

Correct.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Got it. And last.

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

A

I think, we've previously quoted we'd be relatively flat, free cash flow for the full year. And a lot of that bridge obviously is, what I mentioned earlier, the zircon build $50 million of it and then we, absolutely earnings is impact of it as well.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

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Got it. And I know you've chat about this a little bit. But I mean, if the economy remains relatively weak, how quickly can you monetize and sell down that the big zircon and high-grade slag inventories that you've built up here recently in 2024? I mean, I guess that's not a easily knowable question, but that's my concern anyway.

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

A

Okay. I think, Roger, we're very confident in our free cash flow position. I mean, that's why, early in the year, John and I we borrowed that additional $350 million that was to pay down what I called a short-term debt to have liquidity to be in a very strong position for any condition to happen in 2024. And look, we are. I mean, we feel like there is no risk. Look, we have built $185 million of working capital. As John mentioned, it's zircon. It's feedstock, it's ilmenite. It's whole material that has no shelf life, I mean, no, and that at some point we will sell and we will convert into cash.

Look, it's too bad that we had to accumulate that much in 2023, but it will obviously be a relief in 2024. And we don't have any risk of not being able to monetize the sales of zircon or slag or TiO2, for that matter.

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

A

The only thing is that we don't sell slag in the market, right? So, when we talk about selling down slag, it's selling down slag through the production of TiO2. So, we're not a seller of high-grade feedstock out in the market.

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

A

Yeah. I mean at Q2, we had $450 million [ph] production (57:00) liquidity and obviously this bolstered our liquidity, and part of that was, in both cases very strong. We weren't going to make any drastic decisions that will sacrifice the business in the longer-term. So, we would not sell zircon at all costs.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Got it. Thank you very much.

Operator: Thank you. And as there are currently no further questions in the queue, I'll hand the floor back to John Romano, Co-CEO for the closing comments.

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

Thank you for that. And look, thank you for joining us for the call today. And our key priorities for 2023 remain unchanged, and we're going to remain relentless on focusing on our sustainability and safety, continuing to line up production with customer demand, and prudently reducing our cost, managing our key capital projects without losing sight of the long-term benefits to Tronox, including reducing our cost per ton, manage our working capital and free cash flow in the current market environment.

So with that, I'd like to thank you all for joining. And again, thanks JF for all of the great work you've done and really has been a pleasure to be Co-CEO with you and look forward to working with you between now and April 1 and as a board member. So, thank you.

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Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thank you.

Operator: Thank you. This now concludes the conference. Thank you all very much for attending. You may now disconnect your line.

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