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Tronox Holdings Plc (TROX)

Q1 2024 Earnings Call

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CORPORATE PARTICIPANTS

Jennifer Guenther
Chief Sustainability Officer & Head of Investor Relations, Tronox Holdings Plc

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

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

OTHER PARTICIPANTS

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

John McNulty
Analyst, BMO Capital Markets Corp.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Joshua Spector
Analyst, UBS Securities LLC

Frank J. Mitsch
Analyst, Fermium Research LLC

Michael Leithead
Analyst, Barclays Capital Inc.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC

Roger Spitz
Analyst, BofA Securities, Inc.

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Tronox Holdings Q1 2024 Earnings Conference Call. At this time, note that all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. [Operator Instructions] Also note that this call is being recorded on Thursday, May 2, 2024.

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

Jennifer Guenther

Chief Sustainability Officer & Head of Investor Relations, Tronox Holdings Plc

Thank you, and welcome to our first quarter 2024 conference call and webcast. Turning to slide 2, on our call today are John Romano, Chief Executive Officer; 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. 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.

It is now my pleasure to turn the call over to John Romano. John?

John D. Romano

Chief Executive Officer & Director, Tronox Holdings Plc

Thanks, Jennifer, and good morning, everyone. We'll begin this morning on slide 5 with some key messages from the quarter. As mentioned in our preliminary results announcement, we delivered a stronger first quarter than anticipated. This was driven by production costs through our global operate – lower production costs through our global operations, destocking having largely run its course through the supply chain, paired with the demand trajectory outpacing normal seasonal levels, and our ability to respond to that demand through the strength of our global footprint.

Our revenue increased 13% compared to the prior quarter, or 20% on TiO2 and zircon revenue alone, excluding other product sales, which saw a decrease due to non-repeating sales of ilmenite and a portion of our rare earth tailings deposit in South Africa. The 18% increase in TiO2 volumes from the fourth quarter exceeded both our

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guidance of 12% to 16%, and the growth that would be more typical for this time of the year. However, this type of rebound is indicative of what we would expect to see on the front end of a recovery.

Demand improved across all regions and outperformed even more so in Europe, Middle East and Africa, and Latin America, where volumes declined more significantly over the past six quarters. Zircon continued to recover from the trough volumes seen in July of 2023, driven by stronger underlying demand despite the market in China remaining relatively muted.

Our volumes increased 54% versus Q4, which was well above our guidance of 15% to 30%. Pricing for TiO2 and zircon was in line with our expectations.

On the operational side, we incurred significant cost in 2023 from running our assets at lower utilization rates due to softer underlying demand. As we saw the market beginning to turn late last year, we began increasing our operating rates, which had a positive impact on our manufacturing cost. As a result, our first quarter cost improved when compared to both the prior quarter and prior year. This helped drive better than anticipated EBITDA margin of almost 17% and adjusted EBITDA for the quarter totaling $131 million, which was above our guided range.

As the high-cost inventory continues to move through our internal supply chain, efficiencies from investments made in the business to reduce costs will enable margins to return to levels realized prior to the downturn. The first quarter has been a true inflection point. We believe the trends both on the demand side and in reducing our costs will continue going forward. We're well on our way to delivering a step-change in our earnings power, having already worked through much of the remaining high-cost inventory on the balance sheet. Our free cash flow for the quarter was a use of $105 million, but we will begin clawing back this use beginning in the second quarter and expect to generate positive free cash flow for the full year.

I'll let John run through more of the first quarter numbers and the balance sheet, but we're comfortable with where we are from a liquidity and a debt position. We recently consolidated and repriced two tranches of our term loan, which will result in an estimated annual savings of approximately $5 million. I'm proud of how our team has continued to work to strengthen the business. And as we stand here today, we are well-positioned to continue to capitalize on the recovery that is underway.

On the sustainability front, we're happy to confirm that we officially began receiving power from the 200 megawatt solar project in South Africa. This is not only a significant development on our journey to net zero by 2050, as we will realize an additional 13% CO2 emissions reductions from this project alone for a total of 18% relative to our total 2019 baseline, but will also provide some cost avoidance benefit from increasing electricity costs in South Africa.

We're already working on our next power purchase agreement in South Africa, this time on wind, as this is the highest cost contributor to carbon emissions, solar remains a high area of focus. We expect to publish our 2023 Sustainability Report this quarter that will outline these and other key initiatives across emissions, and waste reduction, water management, social initiatives, and more. We firmly believe that preserving our privilege to operate is critical for our strategy today and for our future.

At the end of the day, our people and our planet enable us to carry out our work, and as a result, we have a responsibility to do so in a manner that is both safe and sustainable.

I'll now turn the call over to John to review some of our financials from the quarter in more detail. John?

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D. John Srivisal

Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

Thank you, John. Turning to slide 6, we generated revenue of $774 million, an increase of 9% compared to the prior year, or 13% sequentially, driven by higher revenue from both TiO2 and zircon. Income from operations was $41 million in the quarter and we reported a net loss of $9 million. While our profit before tax of $2 million, our tax expense was $11 million in the quarter. This was due to the fact that we generated higher than expected earnings in jurisdictions where we pay taxes driven mainly by higher zircon sales. As a result, our adjusted diluted earnings per share was a loss of $0.05. As John previously mentioned, our adjusted EBITDA in the fourth quarter was $131 million and our adjusted EBITDA margin was approximately 17%. Free cash flow was a use of $105 million of which $76 million was from capital expenditures.

Now, let's move to slide 7 for a review of our commercial performance. As John mentioned, the recovery outpaced our expectations and drove TiO2 and zircon volume growth versus prior quarter and prior year. Pricing was largely in line with our expectations and consistent with our margin stability program.

TiO2 revenues increased 8% versus the year-ago quarter and 17% versus the prior quarter as sales volumes improved 18% in both comparison periods. The volume increase was driven by both organic demand and restocking, which we saw across all regions with a higher recovery rate in Europe, Middle East, Africa, and Latin America, where volumes declined more notably in the past six quarters. As expected, TiO (sic) [TiO2] (00:07:56) pricing including mix saw 1% decreased quarter-over-quarter.

Zircon volumes increased 54% sequentially. We've continued to see recovery from the trough levels of July 2023 with stronger underlying demand in Q1. Zircon pricing was leveled to the prior quarter.

Revenue from other products decreased 26% compared to the prior quarter, driven by an opportunistic sale of ilmenite and the portion of our rare earth tailings deposit in South Africa in the fourth quarter that, as we had communicated last quarter, would not repeat.

Turning to slide 8, I will now review our operating performance for the quarter. Our adjusted EBITDA of $131 million represented 10% decline year on year, driven by lower average selling prices and mix and higher SG&A. This was partially offset by improved sales volumes, exchange rate tailwinds, and favorable reductions in input cost for materials such as chlorine, coke, caustic soda. Additionally, we saw favorable fixed cost absorption and freight costs as compared to Q1 2023. Sequentially adjusted EBITDA improved 39%. As we mentioned last quarter, we expected to see improvements in costs as we increased our operating rates beginning late last year and continuing into this year.

Compared to Q4, production costs improved $57 million. This was comprised of $32 million relating to favorable absorption and lower cost of market charges from the higher production. $15 million from the Q4 Botlek idle facility charge due the supplier outage that did not repeat in Q1. And $10 million for lower mining costs, primarily from Atlas. By the end of the year, we expect to recover approximately $15 million from insurance claims relating to the downtime at Botlek due to the supplier outage. Both TiO2 and zircon volume benefit to EBITDA was partially offset by the non-repeating opportunistic sale of ilmenite and a portion of our rare earth tailings deposit in Q4, other headwinds versus the prior quarter as expected were price mix, FX, freight costs from the Red Sea impact, and higher SG&A.

Turning to slide 9, I will now review our balance sheet and cash position. We ended the quarter with total debt of $2.8 billion and net debt of $2.7 billion. Our net leverage at the end of March was 5.2 times on a trailing 12-month basis. Our balance sheet remains strong with ample liquidity ahead of anticipated critical, vertically integrated –

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integration related to capital expenditures. As John mentioned, we successfully completed a repricing transaction on two of our existing term loan tranches, which will result in approximately $5 million of annualized interest expense savings.

We also extended the maturity of one of these tranches to 2029. Our nearest term significant maturity remains through 2028 and we have no financial covenants on our term loans or bonds. Our weighted average interest rate in Q1 was 6.5%. 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 earliest tranche of our term loan. Total available liquidity as of March 31 was $629 million, including $152 million in cash and cash equivalents that are well distributed across the globe. Capital expenditures totaled $76 million in the quarter. Roughly 44% of this was for maintenance and safety and 56% was for strategic growth projects. Working capital was a use of $127 million in the quarter. The vast majority of this was related to higher revenue, driving an increase in accounts receivable.

For inventory, we would normally expect to see an increase in the first quarter in preparation for the spring coating season. While we did plan for the upturn by running at higher production rates, that increased demand across our business resulted in inventory being a source of cash for the quarter. Accounts payable was a decrease, which is typical of our Q1 profile.

We declared a dividend of $0.50 per share on an annualized basis in the first quarter that was paid to shareholders in the second quarter.

I will now turn the call back over to John Romano for some comments on the year ahead and our outlook. John?

John D. Romano

Chief Executive Officer & Director, Tronox Holdings Plc

Thanks, John. So with the first quarter behind us, we can confidently reaffirm what we stated in the last quarter. 2024 has already demonstrated a reversal of several trends from the last 18 months, and we anticipate the recovery to continue. On the market, we've already begun to see an uptick in TiO2 demand that is indicative of what we would see on the front end of a recovery. On pricing, we expect TiO2 pricing to reverse its downward trend and improve as we move through the remainder of 2024.

Regarding zircon, volumes continue to improve from the trough levels realized in July of 2023, and there was a significant improvement in the first quarter. Further recovery will be somewhat reliant on China, given its significant share of the overall zircon market. Nevertheless, demand has rebounded even in the absence of a major shift in China.

On the operational side, we incurred significant cost in 2023 in the range of $25 million to $35 million per quarter from running our assets at lower utilization rates due to soft market demand. At the end of 2023, we began increasing our operating rates in line with the demand improvements we were beginning to see in the market, which has and will continue to have a positive impact on our manufacturing costs.

Although we still have some high-cost inventory to move to the business, with sales outpacing our previous guidance, our EBITDA margins will now be in the range of 20% this quarter. We will continue to deploy technology at our sites to reduce costs and improve efficiencies, which will also benefit our cost position as we ramp up. And we're investing in key capital projects to sustain our vertical integration. From a growth perspective, our R&D efforts remain focused on product and process innovations to enhance profitability. Additionally, we're continuing to explore opportunities in the rare earth space.

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Moving to slide 11, I'll now review two key capital projects in more detail. As a reminder, this year we're investing approximately $130 million in two key mining projects in South Africa to replace our existing mines reaching end of life. These projects are critical to continuing our vertical integration strategy and are important to pursue now to ensure a smooth transition to replace existing mines reaching end of life. These investments will maintain our more than $300 per tonne advantage relative to market pricing for feedstock and are very high return projects with internal rates of return in excess of 30%.

Turning to slide 12, I'll review our outlook for the quarter and year ahead in more detail. For Q2, we expect TiO2 volumes to increase between 7% and 10%, and zircon volumes to remain relatively flat, both compared to the first quarter. And we expect TiO2 pricing to increase slightly versus the first quarter. As a result, we're expecting Q2 2024 adjusted EBITDA to be $160 million to $180 million and adjusted EBITDA margins to be in the range of 20%.

Our expectations for 2024 cash uses are as follows. Our capital expenditures are expected to be approximately $395 million. Our net cash taxes are expected to be less than $10 million as the significant capital expenditures in South Africa are deductible. Our net cash interest expense is expected to be $140 million. And we're expecting working capital to be a tailwind. The magnitude of the cash flow will depend on how significant the market recovery is as we move through the year.

Our capital allocation strategy remains largely unchanged. We are prioritizing investments in the business that are critical to furthering our strategy and driving value from our vertically integrated portfolio. And even at this investment level, we expect to generate positive free cash flow for the full year. We will also be focused on bolstering our liquidity and as the market recovers, we'll look to resume debt paydown. We will continue to prioritize our dividend. And finally, we will continue to evaluate strategic high growth opportunities as they arise. Currently, we're focusing on the rare earth space and we will keep the market updated on any key developments as they arise.

That concludes our prepared comments. We'll now move to the Q&A portion of our call. So I'll hand the call back over to the operator to facilitate. Operator?

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QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] One moment for your first question. And that will be from David Begleiter at Deutsche Bank. Please go ahead.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. John, Chinese exports were at an elevated level in March. What do you think is driving that? Is it sustainable? And how much of a concern is it to your forecast for higher prices in the back half of the year?

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

A

Yeah. Thanks, David. Look, the March numbers were significant. If you look at February and March, significant but February numbers were down. And I would say they were not really consistent with what we saw with our volumes in February for Chinese New Year. That being said, to compare Q4 to Q1, it was a significant move. But there's a lot of discussion going on around antidumping. And I would expect part of what's happening there is some repositioning of some inventory. Again, what you're looking at is exports out of China, not imports into Europe. So I think there's an element there. There's also, I think that move from February to March with March being significantly higher, probably had something to do with shipping delays. So no question that the volumes are moving up.

But I think part of that was maybe – normally you'll see a bump in the first quarter. Again, that 500,000-ish tons, if you look at the number for the first quarter it was higher than what we saw last year. But I think part of it might be repositioning volume in anticipation of something that might happen later in the year, maybe in third quarter with dumping.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

And just on the antidumping case, do you expect provisional duties to be enacted? And if so, is it Q3 or earlier? And is there any change yet that you're seeing in customer buying behavior in Europe due to these antidumping investigations?

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

A

Yeah. So, look, it's – I'd say I'm not going to presuppose what's going to happen, but I think there's clearly an indication that if duties go into place, provisional duties should happen sometime at the end of June, maybe the latest early July. So there's an assumption that that is going to happen. In addition to the EU investigation in the last three weeks, there's been two other formal investigation launched, one in India and one in Brazil. So there's lots of moving parts on dumping.

When we think of our forecast, as I mentioned in the last call, because we don't expect a lot of dumping actual duties to be imposed or provisional duties to be imposed before the end of the second quarter there's not a lot of volume moving in our numbers with regards to that. Could there be some positioning? It's possible. It's hard to

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really tell at this stage. And we ought to get some better visibility in that as we kind of move through the balance of this quarter.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much.

Operator: Thank you. Next question will be from John McNulty at BMO Capital Markets. Please go ahead.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Thanks for taking my question. So in terms of the asset utilization rates, obviously, a lot stronger. I think you had $32 million. I think you cited as a reduction in fixed cost absorption. I guess, how should we be thinking about that as we progress through the year? And I guess can you give us some relative assumptions for kind of maybe what utilization rates are at or the change that you've seen that might just give us some ability to calibrate how much more there may be ahead in terms of improvement there?

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

A

Yeah. So, John, I guess from the standpoint of we were pretty clear last year talking about where – on – for the 12 months we averaged capacity utilization across our nine pigment plants at around 70%, in some instances lower than that. But on average, of those nine plants over that 12-month period, it was 70%. And I would say at this stage, we're creeping up north of 80%.

And I talk a lot about the recovery and what's happening. We have to think about where we're coming from, right? We're coming from a pretty low base. We had a very strong quarter with regards to volume. I do believe that that is the front end of a recovery, and it's, those kind of inputs are indicative of what's happening. We saw some of that happening in the back of the end of last year and that's why we started ramping up. And some of that high-cost inventory that we said was going to take maybe more towards the end of the second quarter to work through because the volumes are moving a little quicker than we thought. We're running through that a bit quicker. So we'll continue to evaluate how we're going to run the assets.

We're running at a rate now which is much more consistent. I mean, running assets at 70% on average is a difficult thing to do. So we're still bringing the assets back up. But at the rates we're running at right now, we believe we're running at a much more reliable rate. A lot of those downtime that we had from running at lower rates we don't believe is going to happen again. So those are some of the things that are in the rearview mirror. But we still have some upside depending upon how the market continues to evolve. And as it does, we'll continue to adjust our production through our integrated business planning process, which also factors in how we manage our blends. John, did you have a comment?

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

A

I was just going to say, as John mentioned, as we've said before, we did start ramping up in Q4 of last year. And so just given our vertically integrated chain, it takes three months to six months of flow through. So, you saw a big portion of that go through in Q1. And then we expect that lower – the higher cost inventory to work through by Q2. You'll see probably not quite the same level as you saw in Q1, but pretty significant, and close to that level.

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John McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Okay. No. That's really helpful color. And then I guess as a second or a follow-up, so it does look like the volumes are coming in better than kind of their usual seasonal uptick, both from in 1Q and in 2Q. I guess, how are you thinking about the usual seasonal patterns for TiO2 demand as we go into the back half of the year? Should we assume at this point it does kind of return to a more normalized level or could it be maybe a little less down as we go into the back half?

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

A

Yeah. So, I mean, we had we guided to a 7% to 10% increase in Q2. And I would say that's it depends on the year. I mean, we've had a lot of different second quarters over the course of the last three years with COVID and then the recovery from COVID. So I would say that's not very abnormal, maybe a little bit on the higher side. So it's a little bit early for us to determine exactly what's going to happen in the third quarter, although we're already kind of getting visibility on what that order book looks like.

Typically, in some instances, you could see a third quarter being slightly lower depending upon what year you're in, where you are in a cycle. But in a normal market, you'd see inventory being built in the first quarter and typically you'd consume that inventory in Q2 and Q3 and then you'd build inventory in Q4 as well. So, I would expect it to be somewhat similar to the – we're not expecting right now based on what we're looking, we see a huge uptick in the third quarter volumes. But again, it's a little bit too early. And again, I'm not giving any predictions on what's going to happen on antidumping. But that could have an impact if in – if duties are imposed. And I stress the word if.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Thanks very much for the color.

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

A

Thank you.

Operator: And your next question will be from Duffy Fischer at Goldman Sachs. Please go ahead.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Good morning. Can you walk through the major geographies when you look at your Q2 guide both on price and volume? Can you give us some color on how that will vary between Europe, the US, and Asia?

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

A

Yeah, Duffy. So, look, when we think about the first quarter, as I mentioned in the call, we saw growth in every region. And we saw, I'd say, disproportional growth in the areas where we had further reductions over the last six quarters. So Europe, Middle East, Africa, Asia-Pacific was a bit higher on the growth side. Moving into Q2, we're starting to see what we would normally project in the first quarter for our coatings season build. So the Americas is starting to pick up. We're seeing some green shoots in Brazil.

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But we're seeing pretty consistent growth. But I'd say the difference between Q1 and Q2 that we're starting to see a little bit more growth on in North America. Not to say we didn't see growth in the first quarter, but we're seeing what's more indicative in the northern hemisphere coating season with volumes picking up in North America, and still getting increases in Europe, Middle East, Africa, and Asia-Pacific as well. But I'd say that we're getting a bit more of a push in North America as well in the second quarter.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Okay. And then if you look at your debt ratio, you've talked – I mean, obviously, wanting to get that better. How should we think about how much of that repair comes from just EBITDA moving higher versus how much you actually want to pay down net debt or pay down gross debt from here?

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

So maybe I'll start with what our goal is and it's still to get to, we talked about $2.7 billion to $2.8 billion depending upon gross or net debt. We still have a goal to get to $2 billion. And I'll let John talk about it.

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

Yeah. And I think if you look at the leverage, obviously, it is relating to the net debt, which obviously it's either paying down debt or generating cash. I think as John mentioned in his comments, we will look to bolster liquidity through the end of this year and then hang on the market, pay down debt. But as we mentioned, we do expect positive free cash flow for the year. Q1 was a significant use. So we do expect a pretty significant amount of free cash flow in the last three quarters of the year, which will help that metric.

And secondly, if you take a look at our guide of $160 million to $180 million, we were – we will start producing much better EBITDA year-over-year, even as early as Q2, depending on where we land. But the second half of 2023 was a pretty easy goalpost that we will be able to beat through the second half of the year. So we do expect that our net leverage ratio will go down pretty significantly through the rest of this year and going forward.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

But I guess that was kind of my question. What's the baseline EBITDA you want to use when you look at that ratio? Would you want to use kind of the trough of the LTM as we sit today or is it just going to be the LTM floating as we go through time, which will have a higher EBITDA number behind it?

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

Yeah, definitely the higher level.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Thank you.

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

Yeah, the latter.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Thanks, guys.

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

Thank you.

Operator: Thank you. Next question will be from Jon Spector (sic) [Josh Spector] (00:28:08) at UBS. Please go ahead.

Joshua Spector
Analyst, UBS Securities LLC
Q

Yeah. Hey, guys. Good morning. I wanted to ask if you think your volumes benefited in the first quarter from competitor outages or not, and to the extent that they did or didn't, is any of that a permanent shift in your view and share gains for Tronox that maybe you've locked down the contracts, or give you any of that is more transitory?

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

Hey, Josh. So, look, I guess, when I made the comment that we ramped up our assets in anticipation of what we saw as far as green shoots in the fourth quarter where we saw demand starting to improve. And we were able to respond to that because of, I believe a lot of that has to do with the global strength of our footprint or the strength of our global footprint, having assets on six continents or located closer to our customers. There's a lot of issues with the Red Sea and the Panama Canal. So is there some volume that we were able to respond to because of how we're positioned? I think the answer to that is yes. I'm not exactly sure if I would call that share gain. I would call that being able to respond to what we indicated as the early signs of a pickup.

And I wouldn't expect that – when we think about that moving forward, I made the reference that we're continuing to see growth into the second quarter. So there were a lot of things that were playing into our demand. There was – that growth in our volumes. So you had demand. You had – the supply chain, basically, had worked through all the inventory. So we're getting customers just back to a normal order buying pattern. And there was a little bit of, I'd say, of our volume that did come from our global position, and being able to respond to the demand in all the regions that we're supplying in because, as I mentioned, we saw an uptick in every region that we sold into in the first quarter.

Joshua Spector
Analyst, UBS Securities LLC
Q

Okay. Thanks. Appreciate that. And I wanted to ask on the cost side. So, I mean, John, you mentioned earlier, I think pretty clearly on the sequential improvements that you guys expect. But I guess if I look back a year ago, the operating cost impact, it was minus $100 million plus and it was negative the year before. So just trying to think a little bit longer term, can you recover any of that as we look over the next couple of years? Is that higher operating

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rates or is that related with some of the CapEx projects around the mines? Just helping frame how that layers in over the next couple of years would be helpful. Thanks.

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

Yeah. I think, obviously, the higher production rates we will see, and as we mentioned, we should see that by the end of Q2. Additionally, I think the biggest increase that we've had over the past couple of years is general raw materials have been up from 2020 to 2022. We were up over $400 million if you look at constant volumes in constant currency. So we haven't seen quite the lowering in costs there, about 4% in 2023. We expect high-single digits in 2024. So, we do expect that those – even at those levels, it's unsustainable cost. So we do expect to see that, but likely not in 2024.

Joshua Spector
Analyst, UBS Securities LLC
Q

Okay. Thank you.

Operator: Thank you. Next question will be from Frank Mitsch of Fermium Research. Please go ahead.

Frank J. Mitsch
Analyst, Fermium Research LLC
Q

Good morning and congrats on the beat-and-raise. I want to drill down a little bit more into the fixed cost absorption production level issues. You indicated that this was a negative of over $100 million in 2023. So as we think about 2024 and given the start that you're off to, is it fair to assume that absent those costs, all else equal, EBITDA should be up over $100 million in 2024?

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

Yeah, that's a fair statement.

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

Reasonable math.

Frank J. Mitsch
Analyst, Fermium Research LLC
Q

Okay. Fantastic. Much appreciated because obviously the Street's not there. But I suspect, as I said, given the beat-and-raise, the Street will get there. And then on the pricing side, you indicated that you anticipate a slight uptick here in 2Q versus 1Q. Can you comment at all with respect to the geographic expectations on that?

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

Yeah, Frank. So, in some of the areas where we saw the biggest decline in volume, so over the last six quarters, Europe, Middle East, Africa, Latin America, Asia-Pacific, that's where we're starting to see the market recover the strongest. And that's where we're starting to see some, I'd say, progress on pricing. There's a lot of announcements out there on pricing and I think it's probably worth spending a little bit of time talking about. It takes a little bit of time for price. So any time the market rebounds and that's what we saw in the first quarter, you

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wouldn't normally see that kind of a pickup in the first quarter. So again, what we saw was indicative of the starting of a recovery and it takes a little bit of time for pricing to actually roll through. So when people make announcements, takes time for those announcements to get implemented.

Typically, capacity utilization needs to get to a certain point before, and inventories need to get to a certain place before pricing actually starts to move through. So we're making progress. Again, Latin America, Asia Pacific, Europe, Middle East, and Africa. And as we move into the second half of the year, we'll start to make progress in other regions. But those are the areas where we're starting to get some progress. And like I said, it typically takes a little bit of time to get that pricing traction once the volume comes along, doesn't happen overnight, and we get a lot of questions about why our price was down in the first quarter. That wasn't down. 1% was in line with what we thought and that's largely just mix.

So, we have a good feel for where we are on the second quarter because we've already negotiated those increases. That's why we made that reference to a slight increase. But as we get into the second half and we kind of evaluate how the market's continuing to evolve, we'll continue to make that progress on pricing.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Terrific. John, thank you so much.

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

A

Thank you.

Operator: Next question will be from Mike Leithead at Barclays. Please go ahead.

Michael Leithead
Analyst, Barclays Capital Inc.

Q

Great. Thanks. Good morning, guys. I just have one question, maybe for John or for CFO John. On inventory, dollar inventory decreased maybe 1% sequentially and your sales volumes improved something like 20% sequentially. And you've mentioned you recently burned through a lot of the high-cost inventories. So I would have thought inventories would have declined more. So if you help explain that.

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

A

Yeah. I mean, that's a great question there. Obviously, we did see inventory lower, which normal seasonality in this quarter be a build of it. So you have to take that into account versus looking from overall ending balance to ending balance. But you also have to take a look at, we are a vertically integrated supplier. So it's not just pigment inventory, it's not just zircon inventory, which obviously we're very robust. It's also the mining side of it as well.

Secondly, you did mention some of the costs have come down, but we still carry pretty significant cost on our books relating to the $400 million increase over the past couple of years. So I think that's what's driving the change. But ultimately, we do expect that we will recover a good portion of that $400 million build over time. Frankly, it's – when input costs do go down we will see that. Additionally, once more robust commercial in the second half of the year, just like we saw in 2021, we will see that inventory turn into cash. If you look at 2021 as a reference, we did generate $468 million of free cash flow. So the earnings potential, cash flow potential is there in the business.

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

And specifically on the inventory that we said we drew down that was on TiO2. I mean, we're ramping up Atlas now. So I think John's point is it's, we don't only have TiO2 inventory, we've got pig iron inventory, we've got ilmenite inventory, we've got slag inventory, natural rutile. So it's a whole mixture of things. And I think the key is as – to John's point, as our costs go down, the cost of that inventory goes down. So it's not – there's a days element of inventory and then there's also a value of that inventory, and we expect that to continue to go down throughout the rest of the year.

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

And the other thing to note is, obviously, we do have a contract with Jazan, so we are buying feedstock and that is building our inventory of feedstock.

Michael Leithead
Analyst, Barclays Capital Inc.
Q

Got it. Thank you so much.

Operator: Thank you. Next question will be from Hassan Ahmed at Alembic Global. Please go ahead.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Morning, John. A question on the guidance. You guys reported $130 million in EBITDA in Q1 and, obviously, $160 million to $180 million is the guidance range for Q2. So, I mean, taking the midpoint of Q2 guidance, you're roughly sort of guiding to around $300 million in the first half of the year. And it seems, from all your commentary that earnings momentum is developing, right? So the back half should look far better than the first half. And yet I take a look at consensus numbers and they are slightly shy of $600 million. So which to me seems highly beatable. I mean, is that the fair way of thinking about 2024?

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

Yeah. It's another interesting way to ask the question that Frank asked. But, look, I think your comments are reasonable, right. If you doubled $300 million, you got – you're still shy of the number that we just kind of confirmed with Frank. So we've got some upside as we move through. And I'm not supposed to talk about consensus because Jennifer tells me not to do that. I won't reference that. You did. But, I think your comments are accurate.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Fantastic. Fantastic. And again, just, sort of digging a little deeper into that. You guys talked about fixed cost absorption being $25 milion to $35 million penalty last year, right? So as your operating rates, sort of, move up and you were talking about, sort of, operating rates being, sort of, above 80% now, how much of that penalty was an offset in Q1? How much of it is going to be an offset in Q2? And what does the back half look like?

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

We're not going to provide the back half yet. But I would expect if we continue running at this rate. So I'll let John kind of work through the numbers because we kind of gave you that. It was about $25 million to $30 million in the first quarter. So – but you have to think about how those numbers worked through last year. It wasn't right. We said $25 million to $35 million a quarter, but there were quarters where that number was higher. So, John, you might...

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

I mean, we said in Q1 versus Q4, production costs were up $57 million, $32 million was favorable absorption and lowering of cost or market changes, $15 million from the Botlek idle, and then $10 million from higher mining. So if you take a look at that $32 million or so, and then we did answer it on the Q&A recently, we do expect a similar amount, not quite the amount, but a similar amount in Q2. So if you take a look at that, it's additional to this $32 million that we've quoted. So you're already seeing a good amount of that and that will continue through Q3 and Q4. So that's why we've said that we expect that to recover the $25 million to $35 million from running out lower through Q2.

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

And we're not in – Hassan, I mean, we're not at the rate where we're running at full capacity because again we're seeing the recovery, we're on the front end of it, but we've still got some capacity to respond to further demand improvement as we see the recovery continue. So, we're continuing to come off of -- we've been talking forever about the fourth quarter of 2022 was the bottom it was. And we saw 2023, there was some slow progression. And we're finally seeing, what we would say, is a good indicator of the front end of a real recovery. So as we continue to move through the rest of the year, we'll evaluate that. China is still kind of an unknown. So, if China recovers, you'll start to see impact not only on TiO2 but on zircon as well.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Very helpful. Thank you so much, guys.

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

Thank you.

Operator: Next question will be from Jeff Zekauskas at JPMorgan. Please go ahead.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Thanks very much. When you take a step back and you look at the coatings markets in the United States, they didn't grow in the first quarter and maybe they shrank a little bit. And the coatings markets in Europe, maybe they're flat. And when you listen to the commentary of PPG or Sherwin-Williams, what they say is that they have plenty of TiO2. So when you look at your volume growth, where did it come from? And why isn't it simply just the restocking of lower inventories with volume to fall off? Because the TiO2 growth rate is so much higher than the end market coatings growth rate. How do you assess those different pulls and pushes?

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

Yeah. Thanks, Jeff. I think you got to go back to the last 24 months, right? So let's wind the clock back to the 2022 and 2023 where volumes dropped 15% each year. So over that 24-month period, we lost 27% of our volume. That's not sustainable either. And you didn't hear that kind of a reduction from all of those coatings companies. So there is an element of a tremendous amount of inventory that was in the supply chain that we talked about the destocking effect. So part of it was destocking. And now, we're just getting back to normal buying patterns. We're not back to where we were in 2019 yet.

To get to 2021 levels, 2021 was a boom year for a lot of reasons for the TiO2 industry because people were staying at home, they weren't going out to eat, and they were using products that our products are in. So we're not suggesting we're going to get back to 2021 volumes, but, what we saw over the last two years wasn't sustainable either. And now, we're getting back to what we would refer to as just more normal buying patterns. There has been no significant replacement for TiO2 where 15% of the demand can just drop away on an annualized basis. So when you think about our growth, a lot of that growth is just getting back to normal buying patterns and feeding through that supply chain, which has been bloated with inventory, and has been now depleted and we're starting to see upticks and demand. And I'm not going to speak to what or who you're speaking to with regards to the customers, but we're supplying all of them.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Okay. Thanks very much.

Operator: Thank you. Next question will be from Vincent Andrews at Morgan Stanley. Please go ahead.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Hi. This is Turner Hinrichs on for Vincent. I'm wondering if you could provide some additional color on industry operating rates and how the supply and demand balance has trended by region.

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

So on industry operating rates, we're not going to really comment. It's hard for us to comment on what everybody else is doing. We gave you an indication on where we were, and I would expect as the market recovers, everybody is going to start looking at how – at their operating rates, and how they're going to respond as the demand continues to recover. So, with regards to – the second part of your question, was it regional demand or could you repeat that?

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Supply and demand balance.

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

Yeah. So, look, TiO2 is a global market. So when we think about supply and demand, TiO2 flows pretty freely in a normal market. I would say over the course of the last probably eight months, considering everything that's going

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on and the geopolitical environment, it's been a little bit difficult, more difficult to ship material around. And that's why I made that reference. Our ability to capture maybe the front end of this recovery has been a little bit better poised for us because of our global footprint and having our assets closer to our customers. But Europe, Latin America, and Middle East over the last six quarters was down more significantly. We're seeing that rebound a bit more. China on the demand side, obviously, has been a big part of the growth over the course of the last 10 years with regards to capacity. The exports, kind of, identify that.

But, as far as supply and demand goes globally, there's puts and takes in those regions. But from a demand side, we're starting to see inputs of growth with the exception, as I mentioned, China still a bit muted, but we're seeing growth everywhere as far as our demand goes. Those areas that were further impacted over the last six quarters, we're seeing stronger recovery from a lower base at this stage.

I mean, in North America, as I mentioned, we're starting to see in the second quarter and in the first quarter, but more predominantly in the second quarter, what we would normally see as a normal coating season. So demand in North America starting to impact us as well.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Great. Great. Appreciate all the additional color. Just to confirm, it sounds like there's been some improvement of local-for-local selling this year, perhaps due to higher freight trends. And if you don't mind providing as well, just an update of how global trade flows have been so far this quarter. That would also be of interest.

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

Global trade. Well, look, there's been an impact on global trade flows, but go ahead.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Yeah. Any updates on what you're seeing out of like Chinese exports since the like high March figures or imports and exports in other regions just considering my additional sort of question on local-for-local selling.

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

Yeah. So, clearly, there has been a big bump in March on exports out of China. And again, that's exports. Those don't actually align with the imports going into Europe. So it's my opinion that some of that is probably pre-positioned in bonded warehouses in anticipation for what might be happening on dumping. There has been an impact on a company's ability to move material, and the time to move material from one country to another has been impacted based on what's going on in the Red Sea and the Panama Canal. So again, our global footprint allows us to take advantage of that because we have inventory positioned because of the location of our assets, allows us to respond quicker to ups and downs in demand, and not being impacted as much, I'm not saying it's no impact to us because we do ship globally. But the impacts of the Red Sea and the Panama Canal probably have less impact to us than they do the balance of our competitors.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Great. Great. Thanks so much for all of the color.

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

A

Thank you.

Operator: Thank you. [Operator Instructions] And your next question will be from Roger Spitz at Bank of America. Please go ahead.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Thank you. Good morning. It sounds like a number of the EBITDA and cash flow questions have a large component [indiscernible] (00:49:12) working capital from the excess costs and inventory from 2023? And just to be clear, am I correct in thinking about when you say 2024 is going to be working capital inflow and you're also expecting higher volumes and prices, that that inflow is being driven by working down of the high-cost inventory, the high extra – I'll call it excess cost from running 2023 production slower. So you have the unabsorbed fixed costs in that inventory.

And then related to that, sort of, how much is in there? So December 2023, in round numbers, inventory was $1,425 million; 2022 was $1,275 million; December 2021 was $1,050 million; and then in December 2019 and December 2020 was both $1,125 million. Should we think about the $1,125 million to kind of be like the sort of the normal level once you work through these excess costs in your inventory through, or how should we think about that?

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

A

Let me just make one comment. In 2021, you've got to think about where we were on inventory from a days perspective. So forget about the value. We had inventory that was much lower than where we're comfortable doing it, or where we're normally comfortably operating...

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Right.

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

A

...because that was when things peaked. We ran through 100,000 tons of zircon inventory over and above what we produced. We got our inventory at our locations on the TiO2 side way below where we would normally would be. So there's two things and I'll let John answer this. One is kind of where – what does that mean with regards to a normalized inventory as far as volume and then normalized based on value?

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

A

Yeah. And so, that's exactly right. So, obviously in 2021, we had sold pretty much everything we could produce at that point. So we were at low values of inventory. So I wouldn't take 2021 as a normalized level. We did have to rebuild our inventory as well as our safety stock there. So, starting from 2021, as I mentioned, we did see significant cost increase across the next couple of years over $400 million. So you would expect to get a significant amount of that back, albeit in 2021 we actually did have some pretty favorable contracts. So again, I

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wouldn't expect the full $400 million to come back. But you are right, Roger, in that Q1, we did see some of the benefit from lowering our inventory, the higher – selling the higher cost, we're replacing it with lower cost inventory. But the other thing was, as we mentioned, we did have higher sales volume than we had expected. And so that did drive some of the good amount of the cash flow being, if you will, put it that way, from an inventory perspective in Q1.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Got it. So of the $1,425 million in inventory in 2023, which includes that excess inventory cost, is it the – an extra $100 million that will get the cash flow as you run that through or looking at the historical numbers, it feels like there's, I'm not sure, $200 million of what I'm calling excess cash in your inventory. How much – which is the right – which is the number we should focus on when we think about that?

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

A

Yeah. It's about $100 million.

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

A

Yeah. I know it's $100 million. And, frankly, it will depend. It'll be -- yeah, well, north of $100 million. I think, ultimately it will depend on the size and scope of the recovery, because a big part of it is selling down that inventory in excess of your production levels. And secondly, ultimately, if you – if raw materials do turn, and how significant that does turn in, how costs revert back to more normalized levels.

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

A

And we're not suggesting. We're going to get that in 2024. It's going to be over a longer period of time. But we should be able to recover north of $100 million of that.

Roger Spitz
Analyst, BofA Securities, Inc.

Q

Got it. Thank you very much for that.

Operator: Thank you. And at this time, Mr. Romano, we have no further questions. Please proceed, sir.

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

Okay. Well, thank you. And thank you, all, for joining us today. Look, we're very confident that our vertical integration strategy, as we've talked about at length, will continue to provide a competitive advantage for Tronox. We're optimistic about the short, the medium and long-term potential for Tronox and the value that we continue to create through, what we're kind of referring to as our leading sustainable mining and upgrading solutions.

So with that, we appreciate your time and thank you for your support and interest in Tronox. Have a great day.

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Operator: Thank you, sir. Ladies and gentlemen, this does, indeed, conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines. Enjoy the rest of your day.

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