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Tronox Holdings Plc (TROX)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Tronox Holdings Second Quarter 2024 Earnings Call Conference. 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 Friday, August 2, 2024.

I would now like to turn the conference over to Jennifer Guenther. Please go ahead.

Jennifer Guenther

Chief Sustainability Officer & Head-Investor Relations & External Affairs, Tronox Holdings Plc

Thank you and welcome to our second 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 and Chief Financial Officer. We will be using slides as we move through today's call. You can access the presentation on our website at investor.tronox.com.

Moving to slide 3. A friendly reminder that comments made on this call and the information provided in our presentation and on our website include certain statements that are forward-looking and subject to various risks and uncertainties, including but not limited to the specific factors summarized in our SEC filings. This information represents our best judgment based on what we know today. However, actual results may vary based on these risks and uncertainties. The company undertakes no obligation to update or revise any forward-looking statements.

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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. We delivered the second quarter performance within our previously guided ranges. TiO2 volumes improved sequentially 8% over a strong Q1 performance, and this represented a 16% increase over the prior year as volumes continue to recover from the low levels realized in 2023. This sequential growth reflects an increase in demand that is consistent with our seasonal trends.

Zircon demand was relatively stable compared to the first quarter, which factored in a shipment at the end of the quarter that rolled into Q3. Our pricing for both TiO2 and Zircon increased sequentially, but were both partially offset by unfavorable mix.

On the operations side, our total pigment plant utilization rate in the second quarter was lower than targeted, driven by short-term challenges relating to ramping up our assets. As a result, we incurred higher costs in the second quarter than anticipated and delivered adjusted EBITDA of $161 million at the lower end of our guided range and margins just under 20%. While this will impact the margins of pigment sold in the third quarter, the operating challenges we experienced during the ramp-up in the second quarter are now resolved, and our average pigment plant utilization rate for July was in the 80% range, and we expect this to continue for the balance of the year. We'll discuss these operational dynamics and how it will impact the third quarter costs later in the call.

Our free cash flow for the quarter was a source of $84 million, and we expect to continue to generate positive free cash flow for the second half and full year.

On the sustainability front, we published our 2023 Sustainability Report earlier this week.

Turning to slide 6, I'll briefly review the sustainability-related goals and targets. Our 2023 report details meaningful accomplishments achieved in the past year, driving continued progress toward our previously established sustainability goals. It also reinforces the unwavering commitment to our sustainability strategy, and our purposeful investments in our people, operations, and product portfolio.

In this report, we reinforced our carbon emissions reduction targets, including reducing Scope 1 and 2 carbon emissions intensity by 50% by 2030 against the 2019 baseline and achieving carbon neutrality by 2050 and reducing Scope 3 carbon emissions by 9% by 2025 and 16% by 2030 against the 2021 baseline.

We've made significant progress on our carbon emissions reduction targets this year, with two renewable energy contracts in South Africa that will convert on a combined basis a total of 70% of our electricity in the region from

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coal-based to renewable sources when the second project comes online in 2027. As a result of this latest expected project timeline, we adjusted our Scope 1 and 2 emissions reduction target for 2025 to 25% from 35%.

We're focused on numerous other initiatives, including reducing waste to external landfills, partnering with our top-emitting suppliers to help reduce emissions across the value chain, and our continuous involvement and partnership with the communities in which we operate.

We firmly believe in the importance of safeguarding our operational privilege, both now and in the future. This is why we ensure that sustainability is seamlessly integrated into our business strategy, operations, and culture, and will continue to support our priority to grow the business and create lasting value for stakeholders.

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

D. John Srivisal

Senior Vice President & Chief Financial Officer, Tronox Holdings Plc

Thank you, John. Turning to slide 7, we generated revenue of $820 million, an increase of 3% compared to the prior year, or 6% sequentially, driven primarily by higher TiO2 volumes. Income from operations was $76 million in the quarter, and we reported net income attributable to Tronox of $16 million. While our profit before tax was $55 million, our tax expense was $45 million in the quarter. This was driven by a $16 million valuation allowance in Brazil and losses in jurisdictions where we have pre-existing valuation allowances. As a result, our adjusted diluted earnings per share was $0.07.

As John previously mentioned, our adjusted EBITDA in the quarter was $161 million, and our adjusted EBITDA margin was 19.6%. CapEx for the quarter was $76 million, and we generated free cash flow of $84 million in the quarter.

Now, let's move to slide 8 for a review of our commercial performance. Q2 came in relatively in line with expectations. TiO2 revenues increased 7% versus the year-ago quarter as sales volumes improved 16%, partially offset by 8% decline in price and mix. On a sequential basis, TiO2 revenues increased 8%, driven by improved sales volumes in all regions. Pricing increased 1% over Q1 as expected while unfavorable mix partially offset this increase. Zircon demand remained relatively flat to Q1 as expected, with a slight decrease driven by a shipment rolling into the third quarter. Zircon pricing increased 1% sequentially.

Now, turning to slide 9, I will now review our operating performance for the quarter. Our adjusted EBITDA of $161 million represented a 4% decline year-on-year, driven by lower average selling prices and mix. This was partially offset by improved production costs, including lower input costs for materials such as coke, chlorine, and caustic soda; higher sales volume; and favorable exchange rates. Additionally, our freight costs continued to see rate decreases on a cost-per-ton basis.

Sequentially, adjusted EBITDA improved 23%. Compared to Q1, production costs improved an incremental $20 million on a net basis. This was comprised of a $26 million improvement relating to favorable absorption from lower-cost tons produced in the first quarter that were sold in the second quarter, partially offset by a net $6 million of period costs taken in Q2 due to the lower operating rates. Other tailwinds versus the prior quarter as expected were price mix and volume while FX was a headwind.

Turning to slide 10, I'll now review our balance sheet and cash position. We ended the quarter with total debt of $2.8 billion and net debt of $2.6 billion. Our net leverage ratio at the end of June was 5.2 times on a trailing 12-month basis.

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Following a second quarter sequential growth, our balance sheet remains strong with ample liquidity ahead of anticipated critical and vertically integrated – integration-related capital expenditures. Our weighted average interest rate in Q2 was 5.99%, down from 6.15% in Q1 from the repricing transaction.

We maintain 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 the earliest tranche of our term loan. Total available liquidity as of June 30 was $680 million, including $201 million in cash and cash equivalents that are well-distributed across the globe.

Capital expenditures totaled $76 million in the quarter. Approximately 40% of this was for maintenance and safety, and 60% was for strategic growth projects, heavily weighted on the mining side of the business, which we previously disclosed. Working capital was a source of $39 million, driven by improved accounts payable. We returned $41 million to shareholders, which included the payment for both the first and second quarter declared dividends.

I will now return the call back over to John Romano for comments on the [audio gap] (09:25) and our outlook. John?

John D. Romano

Chief Executive Officer & Director, Tronox Holdings Plc

Thanks, John. So the first half of 2024 has already demonstrated a reversal of some of the trends from the prior two years, and we anticipate that recovery to continue. On a year-to-date basis through Q2, our TiO2 volumes were up approximately 17%, and our Zircon volumes increased approximately 20% compared to the prior year. Although we are not yet back to normalized volume levels on either TiO2 or Zircon, the improvement this year is a demonstration that 2023 was indeed a trough year for volume demand.

In addition to the recovery, we have also seen the launch of several anti-dumping investigations. Most notably, the EU announced a provisional duty last month on Chinese imports, while Brazil and India each have investigations underway. We believe these efforts will be a benefit in the medium and long term, and we will continue to monitor the short-term impacts from these announcements.

On the operational side, this year, we've been ramping-up our assets to meet the increased customer demand over 2023. As we were ramping up, we experienced some operational challenges across our sites which caused Q2 operating rates to come in lower than what we had targeted, and this led to higher costs in Q2 and higher anticipated costs in Q3. Due to the breadth of our geographic footprint, we were able to continue to meet customer demand as we resolve these issues.

We previously indicated that lower utilization rates impacted our business by $25 million to $35 million per quarter, and our startup challenges in Q2 resulted in a similar impact. To put that into context, we incurred roughly half of the impact in the second quarter and expect the remaining half to impact the third quarter, which is included in our outlook. These short-term challenges have now been resolved, and our average utilization rates for July were in the 80% range. We expect to continue running at this rate through the second half of the year, which will result in lower costs and a step-up in our earnings momentum in Q4. As we ramp up, we're continuing to see the benefits of the technology we've deployed at our sites to reduce costs and improve efficiencies.

As we mentioned in the last two quarters, we're investing $395 million in capital expenditures, primarily in the mining side of the business in South Africa to sustain vertical integration. As a reminder, in 2024, we expect to

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invest a total of approximately $130 million in our two South African mining projects, the Fairbreeze Expansion and Namakwa East OFS. These investments will ensure we maintain our $300 to $400 per metric ton advantage from feedstock sourced internally.

From a growth perspective, our R&D efforts remain focused on product and process innovations to enhance our profitability, and we're continuing to explore opportunities in the rare earth space.

Moving to slide 12, I'll now review our outlook. While the macro backdrop for the second half of 2024 is expected to be less robust than previously anticipated, Tronox has realized and expects to continue to realize considerable growth compared to 2023. For the third quarter, we expect TiO2 volumes to decline in line with seasonal norms by approximately 2% to 4% compared to the second quarter. This represents an increase in the high-teens range compared to the third quarter of 2023.

Regarding Zircon, we anticipate stable volumes in the third quarter, which would represent an increase of approximately 160% compared to the trough levels we realized in the third quarter of last year. We anticipate TiO2 prices to increase marginally compared to Q2, and we expect Zircon pricing to remain relatively stable.

On our costs, the higher-cost pigment tons manufactured in the second quarter will impact our profitability as these tons are sold in the third quarter, and this has been factored into the range. Additionally, based on current exchange rates, we expect FX to be a slight headwind in Q3. As a result of these factors and assumptions, we expect third quarter adjusted EBITDA to be between $145 million and $165 million, and our adjusted EBITDA margin to be in the high-teens.

As previously referenced, our average utilization rates are now running at 80% range, and we expect that to continue to the second half of the year. This would result in an improvement in pigment manufacturing costs and a step-up in earnings momentum sequentially in the fourth quarter.

On cash, our expectations for 2024 remain unchanged and are as follows. Our capital expenditures are expected to be approximately $395 million for the year. 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 is expected to be $140 million, and we're expecting working capital to be a tailwind. The magnitude of the cash inflow will depend on the market trends in the second half.

Turning to slide 13, I'd like to briefly remind investors of our capital allocation priorities before turning over to questions. Our capital allocation strategy has not changed. We continue to prioritize investments in the business that are essential for advancing our strategy and maximizing value for a vertically integrated business. We also remain focused on strengthening our liquidity and resuming debt paydown as the market recovers, and our dividend remains a priority.

And finally, we'll continue to assess strategic high-growth opportunities as they emerge, including the rare earth space, which is an active focus for us at the moment. We'll provide more updates on this as developments happen with these projects.

That will conclude the prepared remarks, and we'll now move to the Q&A portion of the call, so I will hand the call back over to the operator to facilitate that. Operator?

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QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of John McNulty from BMO Capital Market (sic) [BMO Capital Markets] (15:41). Please go ahead.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Good morning. Thanks for taking my questions. So I guess the first question is just on the cost impact of the ramp-up issues. So, I think you kind of implied it's about the same as the low utilization rate issues you had over the past few quarters of $20 million to $25 million. So, when you say it's split between 2Q and 3Q, is that potentially $10 million to $15 million each quarter or are you going to see a $20 million to $25 million hit in each of those quarters?

And I guess, more importantly, now that you're at utilization rates where you should be kind of in the 80% plus range, should we be still seeing risk of ramp-up issues as demand and utilization rates climb, or have you kind of reached a tipping point where you've gotten – you're running hard enough now where you realistically won't see material impacts or risks around ramping up further?

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

A

Yeah. Thanks for the question, John. So look, on the first one, I would say that's split evenly, $15 million in the second quarter and about $15 million in the third quarter, from a cost perspective. And we also mentioned that, yeah, there was some FX impact that could impact the business, and that was a headwind. So – and that could be somewhere in the $5 million range.

As far as where we are in the ramp-up, there wasn't really one issue that you can point to on that ramp-up issue. We've got nine plants and even throughout our operations on the mining side of the business, we had some issues ramping up the assets. And we are at that 80% range. We ran the entire month of July at that improved rate. Moving into August, we're seeing the same kinds of things. So when you think about that 80%, that's on average of those assets. And through the rest of the year, we're going to have planned outages, so those numbers will fluctuate. But on average, yes, we're expecting to be at 80%.

We feel like the issues that we had during that ramp-up process have run their course, and that's why we said we felt pretty comfortable about where we are on that run rate, and that run rate remain consistent through the balance of the year. And that's where – when we talk a little bit about the fourth quarter and, typically, you'll see some seasonality in there. We'll talk about that, I'm sure, later with regards to what demand would be because we're not going to really provide a lot of forward look on the fourth quarter as far as the market. But the reason we made those comments is because we do feel comfortable that that step-up in earnings momentum is going to come from lower-cost tons produced that will be sold throughout the balance of the year, predominantly in the fourth quarter.

John, any comments?

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

Nothing else.

John McNulty
Analyst, BMO Capital Markets Corp.
Q

Got it. Okay. No, that's helpful. And then maybe just as the follow-up, so you list on the outlook page working capital is going to be a source of cash. I guess, can you help to frame that a little bit? It does seem like you should have a decent amount of inventory release. But I guess can you help us to think about how big that working capital cash source could be as we look into the back half of the year and for full-year 2024?

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

Yeah. I think we've mentioned that in John's comments that working capital, we expect to be a slight tailwind for the full year. And frankly, it will depend on the market recovery and how Q3 – we obviously have guided on volumes slightly down there but also Q4, depends on where that ends up, that will determine the scope and size of the working capital benefit. But as we did mention, we are ramping up our facilities, so we are building a bit of inventory throughout the rest of the year. But obviously, if that converts to cash flow, much to the free cash flow and be able to use that to pay down – to build cash and have our net leverage go down.

But from an AR perspective, we are seeing increased sales in Q1 and Q2 that drove higher AR in the quarter. Could we use the working capital that will ultimately convert to cash? We are seeing second half of the year, based on what I mentioned on the commercial side, that we would recover some of that in the second half of the year.

And secondly – and finally, sorry, AP was the use of cash in Q1, but we mentioned that that would claw back throughout the rest of the year. We saw that in Q2 and expect to see a bit more in the second half of the year.

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

Maybe just a little bit more color on that. In the first quarter, we saw a big bump in our sales. [ph] It was 18% – was 8% (20:24) in the second quarter. And we started ramping-up, and we didn't hit the targets we were looking at from a production perspective. So in the second quarter, we actually drew inventory down. So, there is a need. John making reference to building some inventory. We've got some plants that actually need to build some of that inventory and make sure we can continue to meet the demand as it's forecasted.

John McNulty
Analyst, BMO Capital Markets Corp.
Q

Got it. Okay. No. That makes sense. Thanks for the color.

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

Frank J. Mitsch
Analyst, Fermium Research LLC
Q

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Good morning, folks. John, if I could just follow up and get a clarification of what exactly you are referring to when you talk about a step-up in earnings momentum in the fourth quarter? You've used that phrase a couple of times. What exactly are you referring to? Are you referring that Q4, your expectation is that it might be more than Q3?

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

A

Well, what I'm referring to is that we're going to have lower costs, and those lower costs will reflect higher margins in the fourth quarter as we sell those tons. So, we're selling higher cost tons in the third quarter because we had lower production rates, which we've talked about. Plants are now running at rate, and the lower cost inventory that we will be selling in the fourth quarter will generate better margins.

So when we made the comments in, I think, the release, we made some reference about the second half being stronger than the first half, but there's lots of things. Again, as a practice, we don't provide any color beyond 90 days. So one quarter out, we don't provide – so we're not providing guidance on the fourth quarter, but there's lots of things that are going to drive fourth quarter. I mean, you've got the economy, the election. Jobs reports just came out, which are an impact. There's inflation. You've also got dumping. Pricing may have an impact on that if there's opportunities to do that. So, just think about normal seasonal fluctuations in the fourth quarter.

And defining normal seasonal fluctuations in the fourth quarter, it's kind of difficult because I'd say, over the last 10 years, there's been lots of anomalies in the fourth quarter. But if you kind of pull all of those out, and I looked at this last night going back to 2007, call it, in a normal season – if you can define normal seasonal adjustments in the fourth quarter, down 5% to 10%. Sometimes we've seen it up significantly, sometimes it's down significantly. So pull 5% to 10%, those – one of the assumptions that even with the volume being down, we're expecting to get earnings potential over and above what we would have in the third quarter because the tons that we're going to be selling are being at lower cost.

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

A

Yeah. I think – Frank, I think you asked a similar question last quarter, and I think that the way you asked it was appropriate because all things being equal, if we did run – if we continue to run in July for the rest of the year, you will see that addback of $15 million to your earnings.

But obviously, as John mentioned, there's lots of things that go into our results, obviously, both on the cost side as well as the commercial side that can impact that. But we are confident that that running at higher rates will have a step change in our cost position. When you did see it in our Q2 bridge, Q1 over Q2, there is a bump-up in that operating cost bar there.

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

A

And I guess at this stage, it's just – it's really hard to determine what our volumes are going to look like because of all these factors that are just a bit – it's a bit early for us to be projecting what that number is going to look like in the fourth quarter. So, that's where that color came from.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Okay. Very helpful, Johns, on the response. And if I could just ask about anti-dumping. Given the favorable news out of the EU, are you seeing any customer or are you hearing of any customer behavior changes in the EU?

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What is your expectation as to how that may play out in terms of pricing and volumes for the Western producers, including yourselves into that region?

And then just lastly on that, any sort of timeframe as to when we might be hearing something regarding Brazil and India?

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

Okay. Yeah. So, Frank, the EU provisional duties were put in place in July, and there's still a lot of time to go through between now and July. But you can [indiscernible] (25:04) end of the year before provisionals could turn into permanent duties. But you've seen already a lot of movement, right? The EU exports from China, in the last two months, have dropped significantly. You saw a big pickup in exports into India, a pretty big pickup into Brazil.

And there is some, I'd say, movement going on. Inside China, for instance, which is not a big market for us, we've seen the Chinese pushing hard to try to pick up more market share. And that's why there's some noise around pricing although we saw a bit of a lift in the second quarter, and we've talked about a lift in the third quarter, a marginal one. There's still a lot of movement regionally due to that activity that's going on, on the assumption that duties in the EU would go into place.

So, we are seeing some activity. I would say, right now, there's still a fair amount of volume that needs to get kind of absorbed. There's a lot of Chinese material sitting over there. But I think, on the mid to long-term, we would see that as an uplift to the business, if they're put in place effectively because, ultimately, the volume and the price implications that are attached to that should lead to better margins for us.

And then as far as India and Brazil go, those investigations are underway. It's our expectations that we should see some sort of indication on what's happening in those two countries sometime maybe late third quarter for Brazil and probably fourth quarter for India. We don't have a tremendous amount of visibility. Those investigations are still, I'd say, more in their infancy as far as the evaluation of what's going to happen there. But those are two big markets. If you just think about it, Brazil is a 180,000-market and there's roughly 100,000 tons of Chinese exports going into Brazil. India is approximately 450,000 tons and trailing 12-month exports into India from China are 278,000 tons. And those tons can only go so many places.

APAC, in general, if you exclude China, it's already 75% to 80% across that region, saturated with Chinese material. So I think if those actions go into place, that should be a lift for the business.

Frank J. Mitsch
Analyst, Fermium Research LLC
Q

Got you. Thank you so much.

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

Thank you.

Operator: Your next question is from the line of David Begleiter from Deutsche Bank. Please go ahead.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.
Q

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Thank you. Good morning. John, on Zircon, can you size the shipment that was pushed into Q3? And on volumes here, what do you need to see that these volumes improve? Is it just Chinese demand or could other factors help drive volume improvement?

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

Yeah. Thanks for the question. That was a couple of thousand tons. It was not a large volume. That's why we said we were largely flat. And normally, you'd see when we – historically, we've talked about rollovers that might have been bulk shipments, these were container shipments, and it wasn't significant.

And to your point, we still haven't seen China recovering on the Zircon side of the business to the extent that – that's why we're talking about flat volumes. It's pretty much where it was in the second quarter. And from a market perspective, Zircon consumption globally is about 50% in China, which is – because it's heavily influenced by the ceramic market. Our position in China is not as significant as it was before. But in order to get the full potential of the Zircon back, we're going to need China to recover. And that's just a bit early for us to determine when that's going to be.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.
Q

Very good. And just on CapEx, given the elevated thing this year, how should we be thinking about CapEx in 2025 and even 2026? Thank you.

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

Yeah. 2024, obviously, is a pretty sizable amount of $395 million, obviously from the mining investments in South Africa. We will see some of that spend in 2026 – 2025 as well. As you know, those are multiyear type of capital projects, but we will see it come down from that level, so we expect to be less than where we were – than where we'll be in 2024, probably in the mid $300 million level.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you.

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

And 2026 should start to trail down from there.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you.

Operator: Next question is from the line of Josh Spector from UBS. Please go ahead.

James Cannon
Analyst, UBS Securities LLC
Q

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Yeah. Hi. Good morning. This is James Cannon on for Josh. I just wanted to poke on the guidance. So if you call out the $15 million impact from the ramp-up outage, your guide is only down $6 million. You're also talking about volumes being slightly down. What's the offset that bridges $15 million to $6 million?

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

We did mention $15 million from the fixed cost leverage, [indiscernible] (30:27) another $5 million of hurt on FX, assuming that rates stay where they are today. I think on the upside, you do – we have said that pricing is expected to increase slightly throughout the quarter as well.

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

Did that answer your question?

James Cannon
Analyst, UBS Securities LLC
Q

Yeah. Thanks. And then just on the CapEx guide, I think you lifted that from $350 million to $395 million. Was that all related with the outage or was there anything else? I think if I look at the second quarter cash flow, you didn't really have any step-up in CapEx there.

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

Yeah. No, $395 million has been our guide for several quarters now.

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

That had nothing to do with any ramp-up issues.

James Cannon
Analyst, UBS Securities LLC
Q

Okay. Thank you.

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

Michael Leithead
Analyst, Barclays Capital, Inc.
Q

Great. Thanks. Good morning, guys. Just one for me. I wanted to follow back up actually on I think, McNulty's working capital question earlier. I think you said you need to rebuild some inventory in the second half. I just – I guess when I look at your income statement, dollar inventory is still at all-time highs, and your days inventory is quite high. So maybe it's a product mix difference, but could you just help triangulate that for me?

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

So I'll make a quick comment on what I was referring on inventories, and that was finished goods inventories on the pigment side. And I'll let John talk about our overall inventory, John?

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

Yeah. So, obviously, pigment inventories, we expect to increase just from the ramp-up. And it will depend on what happens the rest of the year from a commercial perspective.

Similarly, on Zircon, we are building Zircon inventory throughout the year. We are at much lower levels than even in this higher environment in Q1 and Q2, much lower than what our production levels are.

And then from a feedstock perspective, we do continue to run our mines relatively flat out. So you did see a bit of a jump in Q2 which aligns with our pigment assets being down a bit, so we weren't consuming that feedstock through the cycle.

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

There's also an element of cost attached to that inventory. So it's not just tons. Remember, we still have this fixed cost, the high-fixed cost inventory that we've talked about, working our way through in the second half of the year. We had the impact that we talked about earlier where we were ramping up, and we didn't get the benefit of that. So it's not only the tons, it's the actual cost of that inventory that's sitting on the balance sheet that will continue to work through as we migrate to the year and into next.

Michael Leithead
Analyst, Barclays Capital, Inc.
Q

Okay. Thank you.

Operator: Your next question is from the line of John Robert (sic) [John Roberts] (33:29) from Mizuho. Please go ahead.

John Roberts
Analyst, Mizuho Securities USA LLC
Q

Yeah. Thank you. John, I just wanted to follow up back on the earlier tariff discussion there. Are you suggesting that China is going to turn down its production because of the European tariffs and not be able to find new export markets for their volume?

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

Well, I won't presuppose what China is going to do because I've been kind of pondering what they've been doing for the last three years, and I haven't been right yet. That being said, they're already starting to slow production down. We have a plant over there. We're pretty aware of what's happening in China. So, there will be an impact. I mean, if you think about it from a cost perspective, they're moving volumes into other regions of the world on the assumption those EU duties are going to go into place, and they're doing that with price.

At the same time, you haven't seen any improvement in cost. We've stated many times that, at much higher prices, the majority of those Chinese companies or producers are losing money. Ilmenite pricing has not gone down. It's actually starting to trend up. Sulfur pricing, which is another significant input cost for them, has not – it's starting to trend in the upward direction.

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So I think the short answer, John, is that one would have to assume that some sort of consolidation or closures would happen there if there is not a home for what – I mean, if you just do the math real quick, it's got 250,000 tons in India, 250,000 tons in the EU, and 100,000 tons in Brazil. If all of those were to go into place, there's not another 600,000 tons of demand to fill it.

John Roberts
Analyst, Mizuho Securities USA LLC

Q

Okay. And then, I'm not sure what's going on with Venator and Kronos these days, but are there any other competitive dynamics going on in Europe besides the Chinese competition?

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

A

I mean, we typically don't comment on our competitors. I mean, the only thing that's public out there is that Venator sold their interest in the Louisiana pigment plants over to Kronos. That was not a surprise to us. They were the natural buyer since that was their joint venture partner, and we don't see that as a negative.

John Roberts
Analyst, Mizuho Securities USA LLC

Q

Okay. Thank you.

Operator: Your next question is from the line of Vincent Andrews from Morgan Stanley. Please go ahead.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC

Q

Hi. This is Turner Hinrichs on for Vincent. I was hoping that you could speak to TiO2 inventory levels. Specifically, where do you see them in Europe right now relative to normal levels? And what are your expectations as to whether stocking would be a tailwind or a headwind in the near-term? Thank you.

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

A

Yeah. I think last quarter – thanks for the call, Turner. We stated last quarter that there were three things that were driving the lift in demand. That was destocking, customers getting back to normal buying patterns, and then there was an element of demand. So we think destocking has, in fact, run its course. And I'm talking about now customers' inventory, not suppliers' inventory. And I won't talk about industry inventory, I'll talk about ours.

Our inventories have trended down in the first half of the year. We sold more in the first quarter than we produced. We sold more in the second quarter than we produced. So, I made a reference that there is some areas where we actually need to build inventory, but where we feel we are right now based on the second – or the third quarter projection on demand and where we feel we will be in the fourth quarter, we think that our production is in line with making sure we have the inventory that we need to be able to fill our customers' requirements considering all the other dynamics that are going on in the industry.

So, I won't comment on other competitors though but – does that answer your question?

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC

Q

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Yeah, absolutely. Appreciate the color. Do you mind providing a little or a few thoughts on your medium- to long-term capital allocation priorities? Just what they'll be following the paydown of debt and mining project investments that you all are doing right now?

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

Yeah. So I mean, again, we stated in the prepared comments that our capital allocation policy hasn't changed. We're going to continue to invest in strategic projects to maintain our vertical integration. When the market starts to return, we will start to focus on paying down debt, so we can maintain our liquidity and look at our long-term debt portfolio, which we have talked about getting down close to $2 billion will be the long-term target. And then, ultimately and consistently, we've talked about maintaining the dividend. So, not a lot of change on our capital allocation projects.

And obviously then, there are the things that we've talked about, the rare earth business. So we don't have a lot more to comment on that, but that's still something that's continuing to evolve. We're taking a paced approach at that. There's lots of movements going on in that industry as well. We don't want to take a step into that area until we're confident that our plan is going to be something that's viable in the long term, generating good returns for the business long term.

Turner Hinrichs
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thanks. Looking forward to hearing more about it in the future.

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

Thank you.

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

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Good morning, John. A bit of a confusing quarter from a demand perspective. I'm just trying to get a better sense. I mean, you obviously talked about your operating rates not being where you wanted them to be, hence, coming in at the lower end of the guidance range. I'm just trying to get a better feel of underlying demand, right? I mean, on one side of it, some of your raw material providers, [ph] Olin (39:39) in particular, talked about how the TiO2 industry didn't sort of ramp up the way they had expected it to. So, they're disappointed a bit over there. Some of the coatings guys are also talking about demand not being great. I mean, can you just sort of give us a better sense of what demand looks like, be it regionally, be it from an end-market perspective?

And I mean, the added complexity obviously is inventory levels, anti-dumping stuff. There are all these different moving parts. So, I mean, if you could just give us a sense of where underlying demand is regionally and market wise, could you actually hit high levels of demand even without sort of global economies recovering with this anti-dumping sort of stuff that seems to be expanding across regions and the like?

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

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Yeah. Thanks, Hassan. It's a great question because when you think about – there is no shortage of variables out there that are kind of factoring in the answer to that question. But I'll start with your comment on chlorine, right? And that particular supplier that you referenced would be a supplier in the North American market. North America was a big part of that 8%, right? We talked about 8% growth in TiO2 usage, our sales Q1 to Q2. We saw an increase in demand and sales in the Americas. We saw an increase in supply globally. But in the US, I would say that particular asset is running well above 80%, so I'm not exactly sure how that correlates to that supplier, but our chlorine consumption has not pulled back.

Generically, when you just think about the 2% to 4% I talked about in the third quarter demand growth, last quarter, we kind of gave some general ideas that the third quarter could be up, it could be down, and a lot of that was going to be driven by demand. So again, the three things that we said were factoring into this recovery were: destocking had run its course, customers were getting back to normal buying patterns, and demand was that other factor. So we didn't see demand pick-up as much as we would have – maybe initially thought it could have in the third quarter. So, 2% to 4% is absolutely in line with what we would see as far as seasonal demand trends.

Europe right now, for instance, August is typically a pretty weak month because people are on holiday. We're not seeing that. August seems to be pretty strong. So, what's going to happen in September? The order book looks reasonably good for September, but it's still a bit early for that one. Asia Pacific, India for us is – it's an interesting comment because we've had even some internal questions with those exports that went into India. What's happening to our demand there? Our demand is still good in India. We have a very significant position in India supported by the free trade agreement out of Australia, which provides us, I think, some runway to manage through any kind of maybe pre-positioning of Chinese material even though there's more exports going into that region.

So, it's a bit mixed globally. But when we think about the rest of the year in demand and why we're continuing to ramp up, it is in fact to make sure we can hit the demand that we're forecasting. And I made the comment before, we're not back to where we were. 80% capacity utilization is not a recovery by any means. So we still got some upside. It's a big recovery from a trough in 2023, but we still got some runway to move up.

[indiscernible] (43:33)

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

A

Hassan, over the past two years, if you recall, we're down almost 30% from a volume perspective. So, year-to-date, we have seen a significant recovery, but still only up 17% versus that roughly 30%. So, much more room to grow.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

No. That makes complete sense. And maybe I can sort of try to make you guys put some numbers around that, using some of the stuff that you guys have already talked about. In particular, that $25 million to $35 million quarterly hit that you guys talked about from sort of underutilized assets, if that's the right phrase. So, let's assume for a second that you guys continue operating at rates that you hit in July, that 80% figure that you guys talked about. Would that be enough to recover those $25 million to $35 million worth of headwinds, I guess, at that sort of run rate?

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

Yes.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Fair enough. Okay. Thank you so much.

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

Thank you.

Operator: There are no further questions at this time. I'll hand the call over to John Romano for closing remarks. Sir, please go ahead.

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

Thank you, operator. Our team is highly focused on ensuring we deliver our commitments to our stakeholders. And our vertically integrated business model serves as a differentiator for Tronox by providing security of supply from a global footprint that we can leverage to our customers' advantage and co-products that contribute significant value to our portfolio.

Our results wouldn't be possible without the ongoing efforts of our Tronox team though, and I'd like to take this opportunity to thank the Tronox team for their dedication to operating safely and their steadfast commitment to fulfilling our customers' needs.

I thank you for your support and your interest in Tronox, and that would be the end of the call. Have a nice day.

Operator: Ladies and gentlemen, this concludes today's conference. Thank you very much for your participation. You may now disconnect.

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