02-Aug-2018

Tronox Ltd. (TROX)

Q2 2018 Earnings Call

Copyright © 2001-2018 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Brennen Arndt
Senior Vice President-Investor Relations, Tronox Ltd.

Jeff N. Quinn
President, Chief Executive Officer & Director, Tronox Ltd.

John D. Romano
Chief Commercial Officer & Senior Vice President, Tronox Ltd.

Timothy C. Carlson
Senior Vice President & Chief Financial Officer, Tronox Ltd.

Jean-François Turgeon
Executive Vice President and Chief Operating Officer, Tronox Ltd.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to Tronox Second Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. [Operator Instructions] As a reminder, this conference call may be recorded.

I would now like turn the conference over to Senior Vice President of Investor Relations, Brennen Arndt. You may begin.

Brennen Arndt
Senior Vice President-Investor Relations, Tronox Ltd.

Thank you, Shelby, and welcome, everyone, to Tronox Limited's second quarter 2018 conference call. On our call today are Jeff Quinn, President and Chief Executive Officer; John Romano, Chief Commercial Officer; Jean-François Turgeon, Chief Operating Officer; and Tim Carlson, Chief Financial Officer.

We'll be using slides as we move through today's call. Those of you listening by Internet broadcast through our website should already have them. For those listening by telephone, if you haven't already done so, you can access them on our website at tronox.com.

Moving to the next slide, I'll remind you that our discussion today will 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, including those under the heading entitled Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2017.

This information represents our best judgment based on today's information. 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-U.S. GAAP financial terms that we use in the management of our business. These include EBITDA, adjusted EBITDA, adjusted EBITDA margin, adjusted earnings per diluted share, and free cash flow. Reconciliations to their nearest U.S. GAAP terms are provided

in our earnings release and the appendix of the slide deck.

Copyright © 2001-2018 FactSet CallStreet, LLC

Moving to slide 3. It's now my pleasure to turn the call over to Jeff Quinn. Jeff?

Jeff N. Quinn

President, Chief Executive Officer & Director, Tronox Ltd.

Thanks, Brennen, and good morning to all of you. I'll begin this morning with a few comments on the significant progress we've made over the last few weeks towards closing the Cristal acquisition. I'm going to share with you everything that I can that is public, not weekly [ph] throughputs (02:27), are not confidential and sensitive to the ongoing situation. However, due to those constraints, I may not be able to make any further amplification on this subject during the Q&A session. So, please bear with me if that is the case.

As you know, the hearing in the United States District Court in Washington DC to determine whether the FTC is entitled to a preliminary injunction to block our merger with Cristal is scheduled for next week beginning on August 7. We look forward to the opportunity to demonstrate in the District Court as we get in the recent part three hearing before the FTC's administrative law judge how this pro-competitive, output-enhancing combination will benefit customers throughout North America and around the world and position us to succeed in a fiercely competitive global market.

In Europe, we've received approval on July 4 from the European Commission conditional upon divestiture of our 8120 paper-laminate product grade that we supply from our Botlek facility in the Netherlands. As a reminder, our 8120 grade does not represent a significant amount of the volume at Botlek, and we do not believe the divestiture will have a material impact on Tronox.

On July 16, we submitted to the commission and executed definitive agreement with Venator

Materials PLC to divest the paper laminate product grade. The approval process of that agreement has progressed very well. A so-called monitoring trustee has been appointed and has reviewed the definitive agreement and the proposed business plan of our transaction partner. A hold separate manager has also been approved. The whole separate manager will manage the business pending the completion of the divestiture.

Yesterday, we received feedback from the EC on the agreement, and they've agreed to make one minor change that was requested. That revised agreement has been executed by the parties and will be resubmitted to the EC this morning. Under the terms of the commitment entered into with the EC, the divestiture of the paper laminate product grade must occur within 90 days of receiving the commission's final approval of the Cristal acquisition. We anticipate that final approval in the coming days, but the exact timing of that is not within our control.

Also on July 16, as previously disclosed, we entered into a binding Memorandum of Understanding with Venator for the negotiation of a definitive agreement to sell Cristal's Ashtabula, Ohio complex to Venator if such divestiture is required to secure final regulatory approval in the United States.

The MOU grants Venator exclusivity through September 29, 2018 to negotiate that definitive agreement. These negotiations are ongoing and progressing. It was contemplated in the MOU that the definitive agreement would cover the following scenarios.

If the District Court does not issue an injunction, we will proceed to close the transaction promptly upon receiving final approval from the EC.

receiving final approval from the EC.

Copyright © 2001-2018 FactSet CallStreet, LLC

Under this scenario, the Part III administrative proceeding would likely proceed to a conclusion unless dismissed by the FTC. If we receive an adverse ruling from the district court, we have the right but not the obligation to require Venator to purchase the Ashtabula Complex for $1.1 billion. We can either sell to the Ashtabula Complex to Venator at that price or decide to continue to pursue a resolution in the administrative proceeding in front of the ALJ. That is at our sole election.

If after an adverse district court ruling we are left to continue to pursue a resolution before the ALJ but then the ALJ rules against us, we then have the right to require Venator to purchase the Ashtabula Complex for $900 million. If we do not exercise that right, Venator has the right to require us to sell Ashtabula to them for that price. So at that point, it is not just at our election. If we are able to consummate the Cristal transaction without divesting Ashtabula and the paper-laminate product grade divestiture is completed, we have agreed to pay Venator a $75 million break fee.

We expect next week's hearing in the district court to last three days. The judge has limited each side to three witnesses and seven hours of total presentation time. The judge will also consider the full record [indiscernible] (07:30) before the ALJ. Obviously, we don't control the timing of the court's decision after the conclusion of evidence, but we think it's possible that decision could be forthcoming in just a matter of weeks.

The agreement with Venator and the timing of the preliminary injunction hearing enables us to vigorously defend the merits of the Cristal transaction in relatively short order

the merits of the Cristal transaction in relatively short order, while ensuring we are prepared to move forward swiftly with a remedy transaction at a reasonable valuation if a divestiture of Ashtabula is required.

As this process approaches a near-term conclusion, there are obviously discussions ongoing between the parties that could potentially lead to other scenarios or other outcomes, and we cannot speculate on all of these. But I have tried in my comments this morning to address the most likely scenarios.

While we continue to work hard at securing regulatory approvals, we also continue our integration planning efforts, and that picked up the pace of that work as we contemplate a closing as early as September 1.

We plan to hit the ground running on day one following the closing of the acquisition, quickly begin to deliver on the substantial synergies, and get to the business of creating the world's leading TiO2 producer.

As the integration planning has reinitiated and gained momentum, I have had the opportunity to get to know the Cristal organization much better and have been able to spend some time with our future colleagues. We are combining with a great company, a company with great assets, a company with talented and dedicated people, and a rich history. It is also a company that has performed very well despite the uncertainty around the acquisition.

I've had the opportunity in recent weeks to visit many of the facilities around the world, including the Yanbu pigment plant and the Jazan smelter in Saudi Arabia. Based on these interactions and these visits, I am even more excited about the future and the quality of the company that we will build together.

The team here at Tronox looked at many opportunities for growth over the years, and the Cristal organization under Dr. Talal's leadership look at many opportunities over the years as well. But I am convinced that in this deal, the two companies found their perfect dream dates. I am looking forward to leading the combined company

Copyright © 2001-2018 FactSet CallStreet, LLC

and working with the soon-to-be-combined management team to create value for our shareholders and to better serve our global customer base.

Before I turn the call over to John and JF for a discussion of our second quarter results and the market trends that we see, I'd like to briefly share my own perspective on those topics. First, as we expected, we had another strong quarter. Our strong top line and bottom line performance once again reflected the benefits of our vertical integration with all of our assets in full operation in favorable market conditions across pigment, feedstock and zircon.

Our TiO2 business delivered revenue growth of 17%, adjusted EBITDA growth at 37% and adjusted EBITDA margin of 34% and free cash flow of $93 million. Second, I'd like to address the ongoing debate in the investment committee about the direction of near-term trends in the global TiO2 industry. Are we approaching a cyclical peak that will be followed by a downturn or is the cycle solid and what we are currently seeing just a pause that will be followed by another upward turn, [ph] all the way our lower pace (11:27) in 2016 and 2017?

Here at Tronox, based upon everything we see, everything we know and what we believe, we are clearly in that latter school of thought. From our vantage point, we see supply and demand in balance in continued favorable market conditions across the value chain. In pigment, we believe producers globally continue

to run at high utilization rates. And though there may be some transient inventory bills in some sales channels, we believe inventories in aggregate are at normal levels and not excessive levels across the industry. We do not see incremental capacity additions that would materially exceed the levels needed to satisfy demand growth, whether those incremental volumes are sourced from restarts, debottlenecking, the continued ramping up brownfield expansions or greenfield projects.

Again, there may be some transient periods of inventory builds in some regional supply chains, such as those used by Chinese traders and distributors. But we believe the overriding trend is one of balanced supply and demand.

In addition, we are getting traction on our value stabilization initiatives. We are working successfully with our pigment customers on longer-term agreements with the intent to dampen margin volatility across the cycle.

In feedstock and coal products, we see continued tightening of supply-demand balances especially in zircon and high-grade feedstocks. Rising high-grade stock prices in turn will likely put cost pressures on non-integrated pigment producers. However, as a fully integrated producer, we expect to benefit at both feedstock and pigment levels.

I'll now turn the call over to John Romano for a review of the commercial aspects of the quarter and more color on our view of the global market trends, and then to J.F. for an operations performance review. John?

John D. Romano

Chief Commercial Officer & Senior Vice President, Tronox Ltd.

Thanks, Jeff. Moving to slide 4, I'll start with a look at revenue growth in the second quarter compared to the year-ago second quarter, our TiO2 segment revenue of $492 million

segment revenue of $492 million increased 17%. Higher pigment and zircon selling prices were primary drivers of the increase. Foreign currency translation benefited the revenue growth by approximately 2% or $8 million due to the strengthening of the euro. Pigment sales of $354 million increased 16% as average selling prices increased

Copyright © 2001-2018 FactSet CallStreet, LLC

17% or 15% on a local currency basis while sales volumes were 1% lower. Pigment selling prices were higher in all regions.

Titanium feedstock and co-product sales of $123 million increased 23% from $100 million in the year-ago quarter, and the primary driver there was zircon. Zircon sales of $78 million more than doubled from $38 million in the year-ago quarter as selling price prices increased 47% and sales volumes increased 39%. I'll speak more about the favorable market conditions we see in zircon when we walk through the sequential comparison.

Pig iron sales, up $20 million increased 54% from $13 million in the year-ago quarter as selling prices increased 4% and sales volumes increased 52%. This volume gain was primarily driven due to the increase in availability as we brought one of our slag furnaces in South Africa back online. And feedstock and other products, sales of $25 million declined from $49 million in the year-ago quarter due to the timing of shipments.

CP titanium slag sales were $4 million lower than in the year-ago quarter, and there were no ilmenite sales in the second quarter compared to $11 million of ilmenite sales in the year-ago second quarter. We are not actively selling ilmenite in the market at this time in preparation of our expanded internal requirements following the closing of the Cristal transaction.

internal requirements for the – following the closing of the Cristal transaction.

Moving on to slide 5 for the sequential comparison versus the first quarter, our TiO2 revenue of $492 million increased 11%. The increase was primarily driven by higher pigment, zircon and CP titanium slag volumes. Pigment sales of $354 million increased 6% from $333 million in the prior quarter as our selling prices were level on a U.S. dollar basis and 1% higher on a local currency basis. Sales volumes increased 7%, and the euro translation was a $3 million headwind on the pigment sales in the second quarter.

As Jeff said previously, we believe pigment producers globally continue to run at high utilization rates. I would like to add a quick comment about utilization rates. As you track pigment capacity on operating rates, it's important to distinguish between nameplate capacity and effective capacity. Using nameplate capacity as the denominator and the utilization rate calculation can often understate utilization rates and give the impression there's more untapped capacity available than there actually is.

Regarding inventory globally, we do expect to see the short-term effects of some transient inventory builds in Europe and Asia in the next quarter. But these trends are consistent with what we've seen historically, as seasonality tends to shape the demand of our products.

We are getting traction on our value stabilization initiatives as Jeff mentioned earlier. We are working successfully with our pigment customers on long-term agreements with the intent to dampen margin volatility across the cycle.

Moving to titanium feedstock and co-products, sales of $123 million increased 27% driven by

higher zircon and CP titanium slag shipments. Zircon sales of $78 million increased 28% from $61 million in the first quarter as selling prices were level and sales volumes increased 27%.

Over the last several quarters, we have successfully moved a significant portion of our zircon business to six-month price agreements. The fact that selling prices are level to the first quarter is a result of that success and in no way any indicator of a softening in the market. The opposite, in fact, is true as we see – as we continue to see

Copyright © 2001-2018 FactSet CallStreet, LLC

favorable supply/demand balance in zircon and expect to realize higher selling prices in the second half of the year compared to those in the first.

The medium-term outlook also looks favorable as there appears to be no significant zircon mining projects coming on stream until late 2019 or early 2020. Pig iron sales of $20 million increased 5% from $19 million in the prior quarter as selling prices were 3% lower due to product mix and customer mix while sales volumes increased 10%.

Feedstock and other product sales of $25 million increased 47% from $17 million in the prior quarter. CP titanium slag sales in the second quarter totaled $14 million compared to no sales in the prior quarter. And conversely, there were no ilmenite sales in the second quarter compared to $5 million in the prior quarter.

We expect that our high-grade feedstock business will continue to strengthen as we have more opportunities to sell feedstock than we have inventory to support those opportunities at this time.

And with that, I thank you, and I'll turn the call over to JF for a review of our operating performance, profitability, and cash flow in the quarter.

[06LTHN-E Jean-François Turgeon]

Thanks, John. Moving to slide 6, all of our plants are performing well. Our focus and guiding principle across our global guiding principles across our global business TiO2 remain on producing safe, quality, low cost spend for our customer.

Let's first look at our EBITDA performance in the second quarter compared to a year-ago quarter. TiO2 adjusted EBITDA of $169 million increased 37% versus year-ago quarter. Higher pigment and zircon selling price were the primary driver of the increase.

Partly offsetting the strong sales gain were higher input costs notably petroleum coal, electrode and anthracite, and to a lesser extent unfavorable foreign exchange. However, since the second quarter, net coal price are showing sign of moderation. The electrode market continued to be balance and anthracite price are also levering off.

Compared sequentially to the first quarter, TiO2 adjusted EBITDA of $169 million increased 22%. The increase was largely driven by higher pigment and zircon sales volume and favorable foreign exchange, primarily the South African rand. If you recall, foreign exchange headwind on cost significantly hit our first quarter results, principally the rand and to a lesser extent the Australian dollar.

In the second quarter, we recovered about three quarter of that impact. Our adjusted EBITDA margin in the second quarter increased to 34%, up from 31% in the first quarter and 29% in the year-ago second quarter. In last quarter call, I reported on what at the time were severe drought conditions affecting the Western Cape of South Africa, including our Namakwa Sands mine and smelter. I discussed how we managed through those severe conditions in the first quarter without significant disruption to our operations during that period.

I'm very pleased to report that conditions there have improved significantly. The water level at the dam which served our mining operation at Namakwa is now at 100% of capacity, rising from the 60% level in late June. To ensure redundancy, we have commissioned a desalination plant that is scheduled to be operational later this

Copyright © 2001-2018 FactSet CallStreet, LLC

month. This should further minimize the impact on our operation should severe drought conditions reoccur in the future.

Next, I'll give you an update on the Jazan smelter project. Last quarter, we reported that we signed a technical service agreement and an option agreement with AMIC regarding the titanium slag smelter located in Jazan, Saudi Arabia. AMIC, Advanced Metal Industries Company is an entity equally owned by Cristal and Tasnee. The Jazan slagger enables us to further optimize the level of vertical integration between our TiO2 pigment and feedstock operation following the close of the Cristal merge and across the cycle over the long term. We are combining our slagger operational expertise with that of AMIC to work together to ensure the successful commissioning of this world-class smelter.

Under the term of this option agreement, we agreed to lend AMIC the special purpose vehicle that was created up to $125 million for capital expenditure and informational expense to facilitate the startup of the slagger. These funds may be draw down on quarterly basis as needed based on the budget agreed upon Tronox and AMIC.

During the second quarter, we loan $14 million for capital expenditure and operational expense to facilitate the startup of the slagger. The project is progressing well. So we anticipate loan of $25 million in each of the next two quarters.

My team and I continue to drive our very successful operational excellence program to work to offset the impact of foreign exchange and any inflationary pressure. Much in the same way, we overcame them in the last three-year.

As Jeff mentioned, our acquisition integration planning work is very advanced. We are busy planning for the deployment of our operational excellence program across the combined Cristal and Tronox assets to quickly deliver on the substantial synergy in our combination.

With that I thank you and I turn the call over to Tim Carlson for a review of our financial position.

Timothy C. Carlson

Senior Vice President & Chief Financial Officer, Tronox Ltd.

Thank you, Jeff. Moving to slide 7. Our June 30, 2018 debt was $3.17 billion and debt net of cash and cash equivalents was $1.48 billion including $656 million of cash restricted for the Cristal transaction. Liquidity was $2 billion comprised of cash and cash equivalents of $1.69 billion including the $656 million of restricted cash and $312 million available under revolving credit agreements.

Our blended cost of debt was 5.5% in the second quarter, and on June 30, 2018, 34% of our total indebtedness was set at a fixed rate. We expect cash interest expense for the full year net of interest income to be approximately $170 million.

Capital expenditures were $27 million in the quarter. This excludes the $14 million in loans provided for the Jazan Slagger project. The loans are recorded on our balance sheet within other long-term assets and recorded on our cash flow statement separately from capital expenditures. Depreciation, depletion and amortization expense was $49 million in the second quarter.

During the second quarter, we had a net $30 million foreign currency re-measurement gain that was recorded in other income. The gain was primarily driven by the weakening of the South African rand used in the re-measurement of our U.S. dollar denominated open trade and notes receivable positions. This gain is included in

Copyright © 2001-2018 FactSet CallStreet, LLC

our reported EPS and adjusted EPS results. However, it is not included and has been removed from our total company and our TiO2 adjusted EBITDA results.

We are reaffirming our expectation for capital spending, DD&A and cash tax in 2018. The capital spending of approximately $120 million, DD&A of $180 million to $200 million and cash tax of approximately $20 million. Each estimate is on a Tronox standalone basis.

With that, I thank you. I will now turn the call over to Jeff for closing comments. Jeff?

Jeff N. Quinn

President, Chief Executive Officer & Director, Tronox Ltd.

Thanks, Tim. I'll close by reiterating a few of the key points we'd like you to take away from today's call. First, we continue to work relentlessly towards closing the Cristal acquisition and have made significant progress over the last few weeks towards achieving that goal. We are anticipating final approval from the European Commission in the coming days.

Under the terms of the MOU with Venator, we will proceed to negotiate a definitive agreement for the sale of the Ashtabula complex if that divestiture is required to ensure that we are prepared to move swiftly with a remedy transaction at a reasonable valuation. We are making progress in that regard. Our focus is now on next week's hearing in the district court.

As I've said, we look forward to the opportunity to demonstrate as we did in the recent part 3 hearing before the ALJ, how does pro-competitive, output-enhancing combination will benefit customers throughout North America and around the world and position us to succeed in a fiercely competitive global market.

While we continue to work hard at securing regulatory approvals, we also continue our integration planning work. Our acquisition integration planning work is very advanced and has positioned us to hit the ground running on day one following the closing of the acquisition to quickly deliver upon the synergies.

Second, we see favorable market conditions across the entire value chain with supply and demand in relative balance. We believe producers globally are running at high utilization rates, and despite transient inventory builds in some sales channels, inventories across the industry in aggregate are at normal and not accepted levels. We do not see incremental capacity additions that will materially exceed levels needed to satisfy demand growth. We're getting early traction on our value stabilization initiatives with our pigment customers with the intent to dampen margin volatility across the cycle.

We see continued tightening of supply demand balances in zircon and high grade feedstock. As a fully integrated producer, we expect to benefit across the entire value chain from this trend. And third, both Tronox and Cristal continue to perform well. In our first quarter call, we raised our estimate for the 2018 pro forma adjusted EBITDA to the $1 billion to $1.1 billion range that is before synergies. With the benefit of second quarter results, we now expect 2018 pro forma adjusted EBITDA to be at the top of that range before synergies. In addition, we expect year one synergies of $100 million.

As you've heard us say consistently since the day we announced the transaction, this highly synergistic combination is all about increasing the asset utilization, lowering our cost position, unlocking incremental product volumes to serve growing markets worldwide and generate strong cash flow. Our goal remains unchanged. That is simply to create the world's premier TiO2 company for our investors, for our customers, and for our employees.

Copyright © 2001-2018 FactSet CallStreet, LLC

With that, I thank you very much, and we now like to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from John McNulty from BMO Capital Markets. Your line is now open.

John McNulty

Q

Yeah. Good morning. Thanks for taking my question. I guess I had two questions. On the stabilization initiatives that you've been making on the pigment side, can you give us an update as to how far along you are on that and kind of what – where your targets are or where you are at least relative to your targets?

John D. Romano
Chief Commercial Officer & Senior Vice President, Tronox Ltd.

A

Yeah. This is John Romano. Again, as I mentioned on the call, we've made progress with that. We're not going to provide a whole lot of color with regards to exactly where we are by customer, but it's our objective to try to get somewhere in the range of about 50% of our business in line with these agreements, and we're further along with some than others, but we made progress in the second quarter.

John McNulty

Q

Okay. Fair enough. And then I guess a follow-up question regarding the Cristal assets. I know you don't own them yet, so I'm sure there's some curtain up in between you at this point. But I guess in, I guess, some of the court documents that we had – that we have gone through, it looks like that was running kind of in the first half at a run rate of about $350 million of EBITDA. Is that kind of the right type of run rate to think about as we look at 2018 in totality, or is there – are there some puts and takes that we should be thinking about?

A

I think the Cristal business continues to perform very, very well. And as I've said in my comments, my hats off to you, [ph] Kristine (33:32) and the entire team there because in some phase of tremendous uncertainty that they kept their focus and have continued to perform. I think the Cristal results were embedded in Tasnee's earnings release, and we probably cannot – shouldn't speculate beyond that because we don't want to get beyond what Tasnee has disclosed in their release, John.

John McNulty

Q

Okay. Fair enough. Thanks very much for the time.

Operator: Thank you. And our next question comes from Hassan Ahmed from Alembic Global. Your line is now open.

Copyright © 2001-2018 FactSet CallStreet, LLC

Hassan Ahmed

Q

Good morning, Jeff.

Jeff N. Quinn
President, Chief Executive Officer & Director, Tronox Ltd.

A

Hey, Hassan. Good morning.

Hassan Ahmed

Q

Just as we know, obviously no two cycles are the same. But as I've sort of try to sort of think through the previous up cycle, call it y 2010 through 2012, we saw this major escalation in ore price and there was kind of – they're dark and forth in terms of upward mobility, the ore guys would come out announce price hikes. There would be a bit of a margin squeeze on the pigment side. The pigment guys would obviously follow suit. And it seemed that supply demand fundamentals on both ore and pigment were relatively tight.

Now, this time around, obviously utilization rate is quite tight on the pigment side or pricing, thus far, I mean – it's beginning to show some signs of life. But the upward movement in ore prices has not been that significant.

So, two-part question. One is what's your view now having the luxury sort of having your dollars in both places. What's your view in terms of supply/demand fundamentals on the ore side?

And if at all they are tightening and, let's say, that ore prices start moving up in 2019 and onwards, most of the other guys apart from yourself are non-integrated. Would that not translate to further upward movement in pigment pricing going forward in a relatively tight TiO2 utilization rate environment?

John D. Romano
Chief Commercial Officer & Senior Vice President, Tronox Ltd.

A

Yeah. This is John Romano. On the high grade feedstock side, I'd say that it's definitely tightening up. And although we're not selling significant volumes of high grade feedstock out on the open market, prices are moving.

To your point, they haven't been moving, I would say probably as rapidly as they were in the previous up cycle, but there's also been a number of disruptions that have exacerbated the tight supply/demand situation. So, from that standpoint, I would expect that as we move forward, we're going to continue to see pressure on high grade feedstock. And again, that's something that will benefit us because of our vertical integration.

A

Yeah. And as I've said in my comments, I think when that occurs, we'll benefit from that and also benefit from what maybe upward pressure on pigment prices as other producers incur those costs because they're not fully integrated.

Hassan Ahmed

Q

Copyright © 2001-2018 FactSet CallStreet, LLC

Understood. Understood. Now I know you guys mentioned this, there were two calls going on, so I was a bit distracted. But returning back to sort of your views about incremental TiO2 supply and supply demand fundamentals on the TiO2 side of things, obviously all I eyes tend to be focused on China, and particularly sort of certain ore Chinese announcing chloride base capacity out there. Now, two things. One is what's your view in terms of utilization rates in China? Number one.

Number two, it seems that the chloride-based capacity that operates in China operates relatively depressed operating rates, right? I mean, it's a new technology for them and the like. Even if they were to bring about chloride-based capacity, at least in my mind and I'd love to hear your views, I imagine it will take much longer than most people expect.

And eventually, once it comes online, again, similar to what we've seen in the last few years, I would imagine it would run a depressed operating rates. So, again, chloride capacity-specific, question around timing of the arrival of capacity, and what sort of run rate utilization rates we should think about as we think about operating rates for those facilities?

A

So, on the chloride question, based on the announcements that came out from [indiscernible] (38:20), they had indicated a couple of hundred thousand tons coming on line late in 2019. And I think, on the last call, I made the comment that that seemed a bit aggressive considering they just announced it earlier this year. And typically, you're going to see a little bit of a longer transition when chloride capacity tons come on just due to the nature that that's relatively new technology there.

On the sulfate side, when you think about demand or capacity there, you've really got two buckets. You've got the small- and medium-sized plants that typically can't run at rates much higher than low- to mid-70s as far as capacity utilization and then, the bigger plants that are running maybe in the low-80s to mid-80s on that. So your capacity utilization when it's running at its highest, it's nowhere significantly north of 80%. That's why we made this comment on the call regarding what effective capacity is versus nameplate.

nameplate. The nameplate capacity can easily be adjusted if somebody is using a three day run rate, and we don't typically do that.

Hassan Ahmed

Q

Yeah.

A

Does that answer your question?

Hassan Ahmed

Q

Yeah. That's [indiscernible] (39:38).

Copyright © 2001-2018 FactSet CallStreet, LLC

Operator: Thank you. And our next question comes from Matthew DeYoe from Vertical Research. Your line is now open.

Matthew DeYoe

Q

Good morning, gentlemen. So, I know you mentioned we may hear something from the U.S. District Court in a matter of weeks. But does the 90-day time line from the EC impact your ongoing process with the FCC and your ability to maybe go to distance should the case get thrown out?

A

No, I don't think it does matter. I think the timing will work because the closing of the Cristal acquisition is actually a condition precedent to the divestiture of the paper laminate grade. So, I don't think we get into a situation where we're running and we run out trying to get the thing done in Europe.

Matthew DeYoe

Q

All right. That's helpful. And then so we're seeing price pressure in European pigment markets just due to the premium price there and global trade flows capturing the margin. But at some point that's going to run its course in the U.S. market will probably regain its status as the highest global pigment market. So how sheltered from any excess supply do you think the U.S. market will be given quality standards or products trade flows and like?

A

Well look, as we've continued to say with the FCC for the longest time this is a global market and prices tend to move globally, so there'll be points in times where pricing in Europe is higher. There'll be points in times where pricing in the North American market is higher. As we move forward and look Q2 to Q3 based on some of the work that we're doing with our value stabilization program, we don't see a significant change Q2 to Q3 with regards to our pricing, so it ought to be somewhat similar. And I'd prefer not to really get into regional price variances.

Matthew DeYoe

Q

Sure. That's fine. Thank you.

Operator: Thank you. And our next question comes from Jim Sheehan from SunTrust. Your line is now open.

Jim Sheehan

Q

Good morning. Thanks for taking my questions. Could you talk about where we are in high-grade titanium feedstock in terms of reinvestment economics? And also related to that, where do you see the cost being for developing new feedstock capacity?

Copyright © 2001-2018 FactSet CallStreet, LLC

Jean-François Turgeon
Executive Vice President and Chief Operating Officer, Tronox Ltd.

A

Look, it's JF Turgeon, Jim. it's J.F. The high-grade business obviously depends on the ilmenite that feeds those high-grade plants and the value come when you can use the technology that enhance the co-product that you generate from the ilmenite.

And that's why in the case of Tronox, we're very excited with the option agreement that we have signed with Cristal to start their slagger and be able to take low value ilmenite that cannot be used in a chloride pigment plant and convert it into a high-grade feedstock that could make our pigment plant more competitive.

So look, obviously, that slagger was already built. It just needed someone with the expertise and we have the expertise to make it work. So the economics for us were very, very attractive to basically make that slagger run and produce material to fee our plant. That slagger has the capacity of 0.5 million tons of slag, so 500,000 tons. So it's a significant size.

In fact, Jeff and I had the chance to visit the slagger two weeks ago and it's a very well-built asset. And in the fourth quarter of this year, we're going to start operating that unit. Is there a need for additional high-grade feedstock to come on to the market? Absolutely, in time, there will because the ilmenite that could be directly used in pigment production, those mines are running down and they are not easy to find.

What you can find is ilmenite that could be used for high-grade feedstock, but ilmenite that can use directly in chloride production is quite rare. And that's why you will need the high-grade feedstock price to continue to move up to justify further investment so the feedstock can meet the demand of the pigment. I hope that helps...

Jim Sheehan

Q

Great. Thank you.

A

...to answer your question, Jim.

Jim Sheehan

Q

Yes. Yes, it does. And also on the situation in Europe with a competitor having an extended outage and maybe a delayed timeline for rebuilding their plants or perhaps not completing the rebuild, what impact do you think that might have on pricing in the second half of the year? Do you think that Chinese exports into the region are fully offsetting that, or do you expect more price support going forward?

A

Look, with regards to exports into Europe, clearly those have gone up significantly and we're able to track those the import/export stats to show that Loman's taking a significant piece of that volume. Loman has in the recent weeks announced within the last 30 days $50 to $80 of price increase for export volumes. So, it's kind of too early to get any indication of where they may actually be with that. But I would expect that we probably as I had

Copyright © 2001-2018 FactSet CallStreet, LLC

mentioned earlier, we're not forecasting a significant amount of growth on pricing globally and there may be puts and takes regionally.

Jim Sheehan

Q

Thank you.

Operator: Thank you. And our next question comes from Roger Spitz of Bank of America. Your line is now.

Roger Spitz

Q

Thanks very much. It sounds like the slagger will start up in Q4. You're putting $25 million each in more loans in Q3 and Q4. That leaves $61-odd million that you could be loaning I guess for startup cost. Do you expect in 2018 as slagger starts up to put in more loans, do you have – and if so, do you have a view of how much of the additional $60-odd million you'd have to loan into it?

A

And it is on – slagger actually has two furnaces. The first furnace is expected to come up early in Q3; the second furnace in 2019. We've committed loans up to $125 million, $25 million a quarter so we would expect to continue to loan on a quarterly basis in Q1 and Q2 of 2019.

Roger Spitz

Q

Sort of that same $25 million a quarter basis?

A

Correct.

A

Yeah.

Roger Spitz

Q

Great. And I take it from your prepared remarks that those zircon six month contracts – within those contracts, it sounds like prices you have fixed over the six months. Is that is that correct? And has – is that just you or it's more of the other sellers in the industry and buyers in the industry entering six months contract, meaning you're entering a new contractual regime for zircon?

Copyright © 2001-2018 FactSet CallStreet, LLC

A

Yeah. So, look, over the course of the last 12 months, we've been working actively with customers to try to make sure we don't repeat what happened the last time in the market when it peaked. And we believe that along those same lines of value stabilization that six-month pricing agreements for us make more sense, and for our customers.

I can't speak too much specifically with regards to what our competitors are doing at this time, but I believe it's been viewed favorably by our customers. And for us, it's good for planning. And as we move into the second half, as I mentioned, we do see further price improvement on that six-month basis.

Roger Spitz

Q

And you would presumably renegotiate pricing when it rolls over, say, in I guess July 1 or something? Is that what you do or is there – within these contracts...

A

Yeah. We've already been...

Roger Spitz

Q

... [indiscernible] (48:22) evergreen – I'm sorry.

A

I'm sorry. Go ahead.

Roger Spitz

Q

I was going to say...

A

We've already renegotiated...

Roger Spitz

Q

Please go ahead.

A

Copyright © 2001-2018 FactSet CallStreet, LLC

I'm going and if I don't answer your question, you can ask it again. We have already renegotiated pricing for the second half. So, yes, it was done prior to July 1, and we would do that again moving into Q1 of 2019.

Roger Spitz

Q

I guess I was going to add, do these contracts have sort of evergreen where it's basically you just renegotiate the price every six months but the contracts – the volume contracts continue, or is it a new contract every six months looking back...

A

Yeah. I think what...

Roger Spitz

Q

...towards [indiscernible] (49:08) presumably.

A

Yeah. I think what I've specified in the comments was they were

A

Yeah. I think what I specified in the comments was they were six-month price agreements. The contracts are longer than six months. So it's not renegotiating six-month contracts. It's just six-month price agreements with the existing contracts that we have which are longer term.

Roger Spitz

Q

Got it. Thank you very much.

Operator: Thank you. And our next question comes from Duffy Fischer from Barclays. Your line is now open.

Duffy Fischer

Q

Yes. Good morning, fellows. I missed the first part of the call. But just on the deal, the potential deal with Venator, there used to be some thought that maybe one of the remedies would be splitting Ashtabula and only remedying half of it or one of the lines. There doesn't seem to be anything in that agreement. Is that half of Ashtabula remedy off the table now where it's basically either all or nothing?

A

Copyright © 2001-2018 FactSet CallStreet, LLC

Hey, Duffy. In my comments, I tried to lay out the most likely scenarios and the scenarios they're covered under the Venator agreement. It's probably – there are other potential outcomes and remedies that may be less than the entire Ashtabula complex, might be less than one plant or whatever. So I'm really not going to speculate on that. We've kind of outlined what the Venator agreement covers, and we think those are the most likely scenarios.

Duffy Fischer

Q

Fair enough. And then on your inventory question or comment where you said there are parts of the chain where inventory is high, but through the whole chain you think it's normal, where do you see those high levels of inventory, and where do you see the low levels of inventory that would offset the high to make it neutral?

A

Yeah. So on the inventory when we talked about specific channels, it's typically agents and distributors. They will buy regular volumes from us, and I'm talking specific now to Tronox because from us, and I'm talking specific now to Tronox because I can't speak for the rest of the competition. But when they buy from us, they're buying regular volumes. And to the extent they may be building a little bit of inventory in the channel, that's what I'm specifically referring to and that's largely in Asia.

Duffy Fischer

Q

Okay. Thank you, guys.

Operator: Thank you. And our next...

A

I think – yeah, just go ahead.

Operator: [indiscernible] (51:36). Go ahead.

A

I'm just going to add to that because I didn't answer the question on the other side and that was when we say that it's balanced, our inventories are at or below – hen I say at Tronox, these inventories are actually at or below seasonal norms, and when we look at North America and Europe, we don't see any significant build in inventory.

Operator: And our next question comes from Owen Douglas from Baird. Your line is now open.

Owen Douglas

Q

Hi. Good morning, guys. So I just want to go back to the comment about supply/demand balance and ask itt a slightly different way. As far as the period of a time which you're kind of looking forward and saying you believe

Copyright © 2001-2018 FactSet CallStreet, LLC

that the incremental capacity or supply is going to essentially meet demand, can you give me a sense for over what time period and what is that demand growth rate that you guys are anticipating for a pigment?

A

Yes. So, demand growth rate typically runs about 3%. And when you think about consumption being about 6.2 million tons per year in 2017, that's about 180,000 to a 200,000 tons of additional capacity that's needed just to stem and feed the existing demand as it grows at a regular rate. When we think -China, specifically, we don't see any significant growth in capacity moving into 2019. It's largely flat with some larger plants expanding some volume and some other plants actually closing or degrading their plants based on the environmental regulations. So, quite frankly, with the capacity adds that are known out there, they're quite – they're not largely keeping up with demand as it grows at a 3% rate as it is today.

Owen Douglas

Q

Okay. So at this point in the economic cycle, you are still using that 3% CAGR as the baseline expectation?

J.F. Turgeon

A

Yeah. We haven't completed our budget for 2019, yet I used that 3% as an average growth rate over the time period.

Owen Douglas

Q

Okay. Understood. And just a quick one on the feedstock. So, as you guys think about it, so you've divested or you have an agreement – a Memorandum of Understanding for Ashtabula, but I'm just kind of trying to understand on a go-forward basis where do you see the majority of the benefit to Tronox if there were to be a material price move upwards in terms of feedstock? Would that be primarily in terms of thinking about your actual feedstock third-party sales or would it be just more of that implied savings you get by not having to be a big third-party buyer?

A

That's J.F. answering your question, Owen. And it's the latter which is, basically, we're going to use that material internally. And obviously, internally, it's the cost of producing that material that we absorb, so we won't have the pressure of the increased price of feedstock.

Owen Douglas

Q

Okay. Great. Those are helpful. Thank you very much, guys.

Operator: Thank you. And our next question comes from John Roberts from UBS. Your line is now open.

Copyright © 2001-2018 FactSet CallStreet, LLC

John Roberts

Q

Thank you. When you entered into the agreement with Venator for Ashtabula, were you thinking any trust with Venator-Tronox JV wouldn't be an issue for you doing a possible deal with them or were you thinking that Venator would sell that JV to be able to do a deal with you?

A

John, the whole regulatory approval conditions and obligations are something that would be set forth in the definitive agreement that's being negotiated. So, we're very aware of the situation and believe that regulatory approval can be a pain for that, and that will be sorted out in the definitive agreement in terms of what actions may be required in that regard.

John Roberts

Q

Okay. Thank you.

Operator: Thank you. And our next question comes from Vijay Vikram from Goldman Sachs. Your line is now open.

Vijay Vikram

Q

Hey, guys. Just a quick question on – to the extent that you do the Ashtabula sale and you received $1.1 billion, could you just give us some clarity on how would you go about using that? Would that be primarily directed towards debt reduction or [ph] from the year (56:15)? Thanks.

A

Yeah. A chunk of it would absolutely be directed at debt reduction. However, we would look very closely at also opportunities; return some capital with share owners in terms of a share repurchase or a dividend.

Operator: Thank you. And I'm showing no...

A

That's great.

Operator: ...showing no further questions. I would like to turn the call back over to Jeff Quinn for any further remarks.

Jeff N. Quinn

President, Chief Executive Officer & Director, Tronox Ltd.

Copyright © 2001-2018 FactSet CallStreet, LLC

Thank you, operator. I just wanted to thank all of you for being on the call this morning. We look forward

We look forward to reporting our progress as we move forward on each point we discussed today. We look forward to the District Court proceeding next week and the chance to defend the Cristal acquisition on the merits and notwithstanding the focus on securing regulatory approvals.

We have our eye clearly on the ball in terms of running our own business, and we continue to run very well. The business is functioning well, thanks to the talented team we have here at Tronox, not only profitably but very safely as well.

So, thank you for your time this morning, and we'll talk in the next few weeks to update you on the progress. Thank you.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone, have a great day.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2018 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.