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Tronox Ltd. (TROX)

Q3 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Third Quarter 2018 Tronox Limited 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 be given at that time. [Operator Instructions] As reminder, this call is being recorded.

I would now like to introduce your host for today's conference, Mr. Brennan Arndt, Senior Vice President of Investor Relations. Please go ahead.

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

Thank you, Christie, and welcome everyone to Tronox Limited's third quarter 2018 conference call. On our call today are Jeff Quinn, President and Chief Executive Officer; John Romano, Chief Commercial Officer; and 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, a reminder that our discussion 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 both in our earnings release and the appendix of the slide deck.

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. Good morning and thank you for joining us for our third quarter conference call. I'll begin this morning with a few comments on the progress we are making towards closing the Cristal transaction. I will share with you what I can which represents everything that is public, not legally privileged or not confidential or sensitive to the transaction's current status. Due to these constraints, I will not be able to make any further comments on this subject during the Q&A session. So please bear with me in that regard and thanks in advance for understanding the delicacy of the situation.

That being said, I am pleased to report we have made good progress. First, in Europe. As most of you are aware, we received final approval from the European Commission back in the summer to close the Cristal transaction conditioned upon divesting our 8120 paper-laminate product grade produced at our Botlek plant to Venator Materials PLC. Consummation of this divestiture will occur following the approval of the Cristal transaction by the U.S. regulatory authorities. Just to confirm, we have a signed binding definitive agreement for that divestiture and it is not affected in any way by the status of any remedy transaction here in the U.S. Since that agreement was signed and the remedy approved by the EU, that business has been managed by an independent hold separate manager and a monitoring trustee has been in place. So effectively that business is being held separate just waiting to be sold.

Here in the U.S. in late September the exclusivity period under our memorandum of understanding with Venator expired without the two companies agreeing on a potential divestiture by Tronox to Venator of Ashtabula. Upon expiration of this exclusivity period and as a result of the sales process that we had run before entering exclusivity with Venator, we commenced discussions with a well-capitalized global chemical company not currently in the TiO2 industry concerning a potential divestiture of Ashtabula.

Substantial progress has been made in these discussions. As with any complex carve-out transaction there are a lot of details and a few details are yet to be sorted out. But given the pace of progress that has been made, I am optimistic that these discussions will result in an agreement. We have not yet executed a definitive agreement and just as a word of caution until we do so, there can be no certainty that a deal would be reached and no certainty that the deal will be approved by the FTC.

However Tronox, Cristal and the prospective buyer are engaged in ongoing discussions with the FTC regarding the terms and conditions of a potential remedial transaction that would allow the Cristal transaction to proceed with the divestiture of Ashtabula. We are optimistic that these discussions will conclude in the coming days. The FTC is appropriately going through their internal processes in a very professional and thorough manner to ensure that the divestive business will be a viable competitor.

The dialogue and the feedback from the FTC has been constructive and productive and the parties have been responsive and transparent in addressing the questions, concerns and suggestions of the agency. While the FTC must complete its work and internal processes, we are optimistic that the FTC will come to the conclusion that the proposed remedial transaction addresses their concerns about the Cristal transaction and that the proposed buyer is well-qualified and capable of being a strong competitor in the North American TiO2 market.

As I've said all but a few issues have been sorted out in the proposed agreement. In fact a near-final draft definitive agreement with these few open issues highlighted has been tendered to the FTC this morning for its review and comment. This is another important step in our process. Our priority continues to be to close the Cristal acquisition as soon as possible so we can get to the business of unlocking value for our shareholders and better serving our global customer base. We will of course keep you apprised in the coming days of material developments regarding this transaction.

Now moving to slide 4. Before I turn the call over to John Romano and Jean-François Turgeon for a discussion of our third quarter results and the market trends we see, I'd like to quickly share my own perspective on those topics. First, as we expected, our results in the third quarter once again demonstrated the benefits we derive from our vertical integration. Solid performance was realized across the board in pigment, feedstock and co-products with all of our assets in full operation. Our TiO2 adjusted EBITDA margin of 33%, an increase of two percentage points over last year, reflected this broad-based contribution and was achieved despite lower year-on-year sales volumes in pigment and zircon. As we anticipated and communicated to you in last quarter's call, pigment sales volumes in the third quarter were impacted by transient inventory builds in certain sales channels in Europe and Asia. Customers in these channels met their pigment needs in part by de-stocking their inventories.

We are anticipating a return to normal demand and inventory levels as this de-stocking runs its course. John Romano will share his views with you on this important topic in just a few minutes. In addition, we are working successfully with our pigment customers on our unique win-win margin stability initiatives with the intent to dampen margin volatility across the cycle.

In zircon, we continue to see favorable market conditions as a result of a tight global supply-demand balance. We benefited from higher selling prices in the quarter which more than offset lower sales volumes due to shipment timing. As you know zircon like feedstock and pig iron is delivered in large shipments via ocean freight with each shipment representing significant revenue and profits. The shipments are periodic and their timing can be subject to port congestion and weather conditions. So it's not a product that lends itself well to quarter-by-quarter predictability but is better suited to track on a multi-quarter or annual basis.

But suffice it to say zircon is a very attractive product for us that delivers significant profitability and margin enhancement to our TiO2 business. The market for high-grade feedstock also remains tight as a result of industry supply disruptions in the first half of 2018 and declining production at other industry producers' existing operations. As a vertically integrated pigment producer in a rising feedstock price environment, we expect to derive significant and differentiating benefits relative to non-integrated pigment producers. A rising price environment is what we currently see and what we expect we will continue to see across 2019.

I'll now turn the call over to John Romano, our Chief Commercial Officer, for a review of the commercial aspects of the third quarter and more color on our view of the global market trends. And then to Jean-François Turgeon, our Chief Operating Officer, for an operational performance review. John?

John D. Romano

Chief Commercial Officer & Senior Vice President, Tronox Ltd.

Thanks, Jeff. Moving to slide 5, I'll start with a look at revenue growth in the third quarter compared to the year ago third quarter. Revenue of $456 million increased 5% compared to $435 million in the year-ago quarter driven by higher selling prices across all major products including pigment, zircon, chloride process slag and pig iron. The pricing gains were partially offset by lower pigment sales volumes and the timing of zircon shipments that Jeff referred to earlier. Pigment sales of $315 million were essentially leveled to the $316 million in the year-ago quarter as average selling prices increased 7%, also 7% on a local currency basis while sales volumes were 6% lower and in line with what we discussed in our second quarter call.

As Jeff discussed the lower year-on-year sales volumes in our view were the result of transient inventory builds in certain sales channels, primarily in Europe and Asia. Customers in those channels met their pigment needs in part by de-stocking these inventories. Nonetheless, pigment selling prices were higher in all regions. Translation of the euro was a $1 million headwind on revenue in the quarter.

Our titanium feedstock and co-products sales of $131 million increased 21% from the $108 million in the year-ago quarter, driven by higher selling prices of zircon, CP slag and pig iron. Zircon sales of $72 million increased 36% from $53 million in the year-ago quarter, driven by 50% higher selling prices which more than offset the 9% sales volumes that were due to timing of shipments. Demand remains strong in pig iron, especially in the foundry and foundry-grade material. Pig iron sales of $23 million increased 28% from $18 million in the year-ago quarter as selling prices increased 8% and sales volumes increased 17%.

Feedstock and other products sales of $36 million compared to $37 million in the year-ago quarter. Chloride process slag sales selling prices increased 22% and there were no ilmenite sales in the third quarter compared to the $4 million of sales in the year-ago quarter. As we stated in our last call, we are not actively selling ilmenite in the market in preparation for our expanded internal requirements following the closing of the Cristal acquisition.

Now moving to slide 6 for the sequential comparison versus the second quarter, our TiO2 revenue of $456 million in the third quarter decreased 7% from $492 million in the second quarter as higher zircon and pig iron selling prices were more than offset by lower pigment sales volumes and the timing of zircon shipments.

Pigment sales of $315 million were 11% lower than the $354 million in the second quarter. Pigment selling prices were level to the second quarter on a local currency basis. On a U.S. dollar basis, selling prices were 1% lower as translation of the euro was a $2 million headwind. Sales volumes were 10% lower, driven by two primary factors.

First, the normal seasonal decline from the second quarter to the third quarter. The second quarter is the strongest quarter of year typically. The seasonal volume decline from the second quarter to the third quarter is typically in the range to 5% to 8%. And second, the balance of the 10% sequential decline we reported resulted from transient inventory builds we see in certain channels in Europe and Asia as customers met their pigment needs in part by de-stocking inventories.

In North America, a market that represents 40% to 45% of our annual pigment sales, favorable market conditions continued in the third quarter. The fourth quarter is historically the lightest quarter for the year. For this reason we typically expect volumes to decline in the high single-digit percent range from those in the third quarter. Given our expectation of continued de-stocking of transient inventory builds in the fourth quarter coupled with the normal seasonal decline, we expect our volumes to be 12% to 14% lower in the fourth quarter than in the third quarter. We expect selling price levels in the fourth quarter to be similar to those in the third quarter.

Now moving to feedstock and co-products, sales of $131 million increased 7% from the $123 million in the second quarter, driven by higher selling prices for all major products including zircon, CP slag and pig iron. Zircon sales of $72 million were 8% lower than the $78 million in the second quarter.

Selling prices increased 15%, reflecting successful implementation of price increases announced earlier in the year. As a reminder the majority of our zircon business is on six-month contracts that begin in January and July of each year. Similar to the year on year comparison these higher selling prices were more than offset by the 19% lower sales volume due to shipment timing.

We are currently expecting increased zircon shipments in the fourth quarter versus the third quarter. As a result we anticipate double-digit sequential zircon growth in the fourth quarter.

Pig iron sales of $23 million increased 15% from $20 million in the prior quarter as selling prices increased 7% and sales volumes increased 7%. Similar to zircon, our pig iron shipments are also subject to shipment timing. We are currently expecting increased pig iron shipments in the fourth quarter versus the third quarter and expect double-digit sequential revenue growth in pig iron in the fourth quarter. As a reminder the contribution margin for pig iron is significantly lower than zircon. So while the sequential increase in pig iron shipments will help our top line significantly, less of an increase will pass through to adjusted EBITDA.

Feedstock and other products sales of $36 million increased 44% from $25 million in the prior quarter driven primarily by higher sales of CP slag and slag fines. There were no sales in the third quarter – there were no ilmenite sales in the third or second quarter. As I said earlier, we are not actively selling ilmenite in the market in preparation of our increased internal requirements following the closing of the Cristal acquisition. We are also currently expecting increased CP slag shipments in the fourth quarter versus the third quarter and as a result we expect our fourth quarter CP slags to be roughly double those of the third quarter. And finally, we sold our non-strategic Electrolytic business on September 1, and as a result, approximately $15 million of quarterly revenue will no longer be reflected in our results.

And with that, I thank you and I'll turn the call over to JF for a review of our TiO2 operating performance, profitability and cash flow in the quarter.

Jean-François Turgeon

Executive Vice President and Chief Operating Officer, Tronox Ltd.

Thanks, John. Moving to slide 7, all our plants are performing well. As Jeff said, our third quarter result clearly reflect the benefit of our vertical integration with all our assets in full operation. Our guiding principle across our global TiO2 business is to produce safe quality, low-cost [ph] done (00:18:58) for our customer. One measure of the high level of our performance in the quarter was our adjust EBITDA margin of 33%. This represent a 2 percentage point increase over last year, despite lower pigment and zircon sales volume than a year ago. And when comparing it to the adjust EBITDA margin in the first two quarter of the year, it is also an indication of our consistency, our adjust EBITDA margin was 34% in the second quarter and 31% in the first quarter.

Let's first look at our EBITDA performance in the third quarter compared to a year-ago quarter. TiO2 adjust EBITDA of $150 million increased 10% from the $136 million in the year-ago quarter. The primary driver were higher selling price for pigment and zircon and to a lesser extent favorable foreign exchange on costs.

In the quarter, we benefit from favorable movement in the South African rand and Australian dollar relative to the U.S. dollar. Partially offsetting the increase were lower pigment and zircon sales volume that John covered plus higher production costs primarily from petroleum coke, anthracite and electrode.

Looking at the sequential comparison versus the second quarter, TiO2 adjust EBITDA of $150 million decreased 11% from the $169 million in the prior quarter. The major factor driving this are essentially the same as on the year-on-year comparison. Higher selling price and favorable foreign exchange on costs were more than offset by lower sales volume and higher production costs, in this case, primarily process chemical and energy. Also in the quarter, we successfully signed new union labor agreement in South Africa which are notably longer in term than the prior agreement. At our largest site, Namakwa Sands, the agreement will last five year and at KZN Sands the agreement would last three year.

TiO2 also delivered strong free cash flow of $120 million in the quarter. Cash provided by operating activity was $148 million and capital expenditure were $28 million as we continue our disciplined approach to capital spending.

Moving to an update on the South African Mining Charter. During the third quarter, after receiving comments from industry participant, the South African Department of Mineral Resource or DMR published for implementation a revised Mining Charter. The revised Mining Charter, commonly referred to as Mining Charter III, met with mostly positive response by the South African Mineral Council and other industry participant. The DMR will publish implementation guideline by the end of November 2018.

The implementation of the new Mining Charter will provide a greater degree of certainty than has previously exist for the South African mining industry. This is very positive.

Next, we would like to give you an update on the Jazan smelter project. As you know, earlier this year we enter into a technical service agreement and an option agreement with AMIC, the owner of the smelter. AMIC is an entity equally owned by Cristal and Tasnee. Under the technical service agreement with AMIC, we agreed to provide technical advice to AMIC to facilitate their start-up of the smelter. The Jazan smelter represent one path for us to further optimize the vertical integration between our pigment production and feedstock production after the closing of the Cristal transaction.

Under the option agreement AMIC grant us an option to acquire 90% of the special purpose vehicle to be create which will be comprised of AMIC's ownership of the smelter and $322 million of debt currently held by AMIC. During the term of this option agreement we agreed to lend AMIC up to $125 million for capital expenditure and operational expense intended to facilitate the start-up of the smelter.

These funds show up as a loan on our balance sheet and may be draw down on a quarterly basis as needed, based on a budget reflecting the anticipate needs of the smelter start-up. However, our obligation to fund up to $125 million is contingent on our continued reasonable belief that this amount will be sufficient, in addition to any amount supplied by AMIC to bring the smelter up to certain sustained production level. Through the end of the third quarter, we loan $39 million for capital expenditure and operational expense to facilitate the start-up of the smelter. An additional $25 million was loan on October 1, 2018, bringing the total amount of loan exposure to $64 million. AMIC recently attempt to start-up the smelter, but was unsuccessful.

Through our technical service agreement, we are monitoring and assisting AMIC investigation to understand the root cause of the technical issue. Both Tasnee and Outotec, the engineering and construction firm for the project, have made public statements regarding the status of the project and I would refer you to those statements for more detail. We are currently evaluating whether our future commitment under the option agreement which today stand at $61 million will be sufficient to bring the smelter up to the specified sustained production level.

Moving to the Cristal acquisition, as Jeff said, we are optimistic that it will soon be a reality. Our integration planning work is very advanced. And we are ready to deploy our operational excellence program across the combined Cristal and Tronox asset to quickly deliver on the substantial synergy in our combination. We look forward to reporting our progress in merging our two operation and delivering the substantial synergy inherent to our combination.

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

Timothy C. Carlson

Senior Vice President & Chief Financial Officer, Tronox Ltd.

Thank you, JF. Moving to slide 8 and beginning with our balance sheet. On September 30, 2018, debt was $3.17 billion, and debt net of cash and cash equivalents was $1.43 billion, including $659 million in cash restricted for the Cristal transaction. Liquidity was $2.01 billion comprised of cash and cash equivalents of $1.74 billion including $659 million of restricted cash and $271 million available under revolving credit agreements.

Our blended cost of debt was 5.6% in the third quarter and on September 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 $160 million to $170 million.

Capital expenditures were $28 million in the third quarter. This excludes the $25 million in loans provided to the Jazan smelter project in the quarter. As JF mentioned the Jazan loans are recorded on our balance sheet within other long-term assets, and are reported on our cash flow statement separately from capital expenditures.

Depreciation, depletion and amortization expense was $48 million in the third quarter. We have fine-tuned our expectations for capital spending, DD&A and cash taxes for the year with capital spending of approximately $120 million to $125 million, DD&A of $185 million to $195 million and cash taxes of approximately $20 million to $25 million. Each estimate is on a Tronox standalone basis.

With that, I thank you and I'll 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 summarizing the key points that we'd like you to take away from today's call regarding the status of the Cristal acquisition, the significant and differentiating benefit of our vertical integration strategy and our priorities over the next few months.

First the Cristal acquisition, just to reconfirm my earlier comments. We're making substantial progress in our discussions with a potential buyer of Ashtabula. Together with Cristal and the prospective buyer we are engaged in ongoing real-time discussions with the FTC regarding the potential remedial transaction.

We are optimistic that these discussions will conclude successfully in the coming days and as the FTC completes its internal processes and their review of the proposed divestiture transaction. The FTC is appropriately and thoroughly going through their internal processes to ensure that the divestive business will be a viable competitor.

We are absolutely committed to assisting in that necessary and appropriate work. Our dialog has been and will continue to be constructive and productive and the parties will continue to be responsive and transparent in addressing the questions or concerns of the agency.

While there can be no certainty that the FTC will approve the proposed remedial transaction, we are optimistic that the FTC will come to the conclusion that the proposed remedial transaction addresses their concerns about the Cristal acquisition and that the proposed buyer is qualified and capable.

Our priority continues to be to close the Cristal acquisition in the coming days so we can get to the business of unlocking value for our shareholders and better serving our global customer base. Second, we expect to continue to derive significant and differentiating benefits from our vertical integration. We see generally favorable market conditions across our value chain with supply and demand and relative balance over the medium and long term.

Our plants across the entire value chain continue to run well under John François's leadership. Yes, there are macro factors that we are watching closely including geopolitical tensions, the China economic growth, rising interest rates, exchange rate fluctuations, rising cost structures and certainly trends in housing and auto demand. Some of these factors have impacted current conditions in our industry such as the transient inventory builds in pigment [ph] were seen in (00:33:01) certain sales channels in Europe and Asia. However, we believe that across our value chain inventories and aggregate are at normal and not overly excessive levels. In addition we do not see incremental capacity additions in pigment or feedstock that would materially exceed levels needed to satisfy demand growth over the next couple of years.

We are anticipating a return to normal demand and inventory levels in pigment as these transient inventory de-stocking that we've mentioned are depleted. It's just a question of when. We see continued favorable market conditions in zircon with a tight global supply-demand balance. We also see tightening supply-demand conditions in feedstock. As a fully integrated producer, we expect to benefit across the entire value chain from these market conditions.

From our vantage point, the medium- and long-term outlook for our vertically integrated position in the industry is good. As we anticipate the closing of the Cristal transaction, we have reviewed our vertical integration strategy and remain convinced that this strategy will differentiate us in a variety of market conditions as we move forward. Our goal remains unchanged. That is to create the world's premier TiO_2 company for investors, for our customers and for employees.

As you have heard us say consistently since the day we announced the Cristal transaction, this highly synergistic combination is all about increasing asset utilization across the value chain, lowering our cost position, unlocking incremental production volumes, and generating strong cash flow. With the benefit of our third quarter results and the year-to-date results of Cristal, we estimate that 2018 pro forma adjusted EBITDA will be in the range of $900 million to $950 million excluding Ashtabula and before synergies. The next few weeks before the [ph] New Year (00:35:16) will be about getting the Cristal deal closed, beginning our integration efforts, completing the 8120 and Ashtabula remedial transactions, and setting up a successful 2019. As we close out the year, we also expect to be able to share with you progress on the potential Exxaro share sale and our re-domiciling transaction to the UK. In late March as we near what we believe will be the end of our first full quarter with the Cristal TiO_2 business in our portfolio, we'll be holding an Investor Day. At that time we will more fully introduce to you our global management team, share with you our vision for creating premium shareholder value, outline our strategic and capital allocation priorities and demonstrate what we believe truly makes Tronox different. We look forward to that discussion and look forward to seeing you here in New York in the spring. With that, I thank you. And now we'll turn it back over to Christie the operator to open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from the line of John McNulty with BMO Capital Markets. Your line is open.

John P. McNulty
Analyst, BMO Capital Markets (United States)

Q

Yeah, good morning. Thanks for taking my questions. So I guess a couple of things. On the synergy expectations around Cristal and now that it looks like Ashtabula has to go and you've also got the 8120 move as well, I guess how should we be thinking about what kind of the net synergy number's going to be going forward.

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

A

John, as we move into the new year and get the transaction closed, we'll be refreshing our view on synergies. We still expect frankly that all of the cost reduction synergies and everything are there. The baseline for which those synergies were originally estimated is our 2016 baseline. And so when we get the transaction closed, we'll be giving you an update of that. But all of the synergies that we see in terms of all the different buckets and everything are still there. And we'll just refresh the estimate [ph] a bit (00:37:46).

John P. McNulty
Analyst, BMO Capital Markets (United States)

Q

Okay. I appreciate that. And then, when you think about the inventory issue, the kind of the speed bump that's out there, I guess how are you adjusting to that in terms of your production levels, like how should we be thinking about that? And how long do you expect this to continue to be a headwind? I mean, do we largely get through it as an industry by the end of the fourth quarter or does it drag into the first half of next year? How are you thinking about it at this point?

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

A

So when we think about, as far as production we're running our plants at regular rates. I think when I made some points earlier with regards to where volume is versus – and we're projecting in the fourth quarter versus the third quarter, there's a seasonality impact of it. And then, these transitional inventories are about another 3% to 5% on top of that. So it's not what I would describe as significantly different than what we would normally see in the fourth quarter.

JF, I don't know if you have any other comments?

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

A

Yeah. And maybe, John, I can add that we started with a position where our inventory were lower than normal. So obviously when you have a little bump like that, it's not a problem to go back to normal inventory. And as I had mentioned in previous call, the fourth quarter is always the quarter where we put our plants in good condition. So it's the time of shutdown for our operation, and we obviously managing those shutdown in what [ph] I call a cost (00:39:15) fashion. So we're not driving for volume, we're driving for cost efficiency and that's how our shutdown are being managed at the moment.

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

A

Yeah. And that's part of just the regular normal annual cycle where we really position things [ph] to the strong coating (00:39:31) season that comes in the spring and that's no different than usual in terms of anything that we're doing there.

John P. McNulty
Analyst, BMO Capital Markets (United States)

Q

Got it. And then maybe just one last follow up on with regard to the potential for re-domiciling in the UK, I guess can you help us to think about what some of the benefits to that might be and the timing of when we might see that actually roll through?

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

A

Yeah. John, I mean there are numerous benefits, significant governance benefits, significant greater flexibility in terms of things like share buyback and things that are shareholder value enhancing and that is something that we're working on like real time and we expect to have an update on that before the end of the year and it would be something that would be consummated we believe early in 2019, sort of the first quarter of 2019. But we believe there are significant governance benefits and flexibility in terms of various actions that can drive shareholder value.

John P. McNulty
Analyst, BMO Capital Markets (United States)

Q

Great. Thanks very much for taking my questions.

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

A

Thanks, John.

Operator: Thank you. Our next question is from Duffy Fischer with Barclays. Your line is open.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Yes. Good morning. I realize you guys can't [ph] give (00:40:50) anything...

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

A

Hi, Duffy.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

...about the deal itself, but some stuff around the deal, if the deal gets done as you kind of laid out here with that other third party, do you have to pay the $75 million to Venator that was in the one MOU you talked about or that you signed? And two, is this smelter contingent on the actual deal happening or could that be something that if the deal actually didn't happen is completely separate and you could go one way or the other on that?

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

A

Okay. To answer the last question first is probably the smelter probably would only happen if the deal does happen because if we ended up not buying Cristal we would have significantly less incentive to help them get that up and running. But the deal could happen without the smelter part happening on the option agreement. In terms of the Venator MOU and the break fee, a number of conditions have to be satisfied for the break fee to be payable. The Cristal deal has to close, the 8120 divestiture has to close and Venator has to otherwise have complied with all of its obligations under the agreement. So that's an ongoing thing that we'll develop as the Cristal transaction closes and we move towards the end of the year.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Okay. And then just one question on the high-grade ore, so far we've had a number of the Western players talk about volumes this quarter and kind of what they're looking forward to in the fourth quarter. It looks like volumes are going to be down high single-digits, maybe low double-digits on aggregate. Western players use a lot more, a higher percentage of the high-grade ore. That plus the unplanned outages earlier this year, why wouldn't that be in a little bit of oversupply as we get into next year with lower consumption of it the back half of this year and then more supply of it in the first half of next year and kind of be at a risk from a price standpoint?

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

A

Look, Duffy, it's JF here. And, look, in our case as a standalone Tronox, we have excess high-grade feedstock and we obviously have seen a lot of synergy in this combination with Cristal because we'll be able to use all of that extra feedstock to alleviate the tight supply-demand situation that exists at the moment. So that's good for us and that's obviously with that in mind that we [ph] have to take (00:43:33) decisions in the third quarter like the one John talked about where we decide not to sell ilmenite and keep it for our future need. We also had put our smelter in a good operating condition, so this year we realized one of our furnace rebuilt and we did that in between quarter two and three, so all of those decisions were done so Tronox would be in a good situation to react positively to this tight supply-demand on the high-grade feedstock.

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

A

I think there's also an element though, when you think about the inventory that we referenced going into 2017, we had I would say well below seasonal norms of inventory as Tronox and so as we move into the fourth quarter as we mentioned a bit earlier, there's not a big adjustment being made from a production standpoint on our side because we are still at a level where we're comfortable with seasonal norms on our inventory going into the fourth quarter.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Great, thank you guys.

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

A

Thanks, Duffy.

Operator: Thank you. Our next question is from Frank Mitsch with Fermium Research. Your line is open.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Hey, good morning gentlemen and I must say I can't wait for the "coming days." And just a follow-up, Jeff, you indicated that you want to give greater details around synergies, refresh the numbers as you said, I guess at your Investors Day, but is there any reason for investors to think that there's any material changes one way or the other relative to what you've previously laid out and that it simply just kind of updating numbers, et cetera, but the core of the synergies are still kind of around the levels that [ph] were (00:45:27) talked about before, the $200 million after a few years.

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

A

Yeah. Frank, I think that's absolutely true and I certainly don't want to create any impression to the contrary. I think what I was talking about is that as we move forward we'll be comparing the synergy estimate to just an updated baseline and so the exact quantification [ph] may vary around (00:45:48) on the margins. For example if there are positions that in the consolidated company that we would have eliminated but those positions hadn't been filled, as we update the baseline that will change the number. But I think the important thing is all of the big buckets remain unchanged and order of magnitude-wise all of the quantification we don't expect to change. So especially in that longer-term number it's still a very solid number.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

All right, terrific, very helpful. And John, I think you were talking about the decline in the fourth quarter 12% to 14% of which it seemed like 3% to 5% is the de-stock. So it's really – the vast majority of the decline is just something that you see every year, correct?

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

A

That's correct.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

All right.

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

A

This decline that we're talking about on de-stocking [ph] assuming not (00:46:41) significantly different than what we saw in the third quarter either.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Very helpful. Thank you so much.

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

A

Thank you.

Operator: Thank you. Our next question is from Hassan Ahmed with Alembic Global. Your line is open.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Morning, Jeff.

I

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

A

Hi, Hassan.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Jeff, obviously fairly favorable comments on the mineral sands side of the operations and as one thinks through sort of past cycles it seems to be playing out in line with that where obviously you see a run-up in utilization rates/pricing for TiO2, and then there tends to be a two- to four-quarter lag between all following suit. So, it seems that it's moving in that direction. So, as I sort of sit there and think about 2019, a two-part question: one is, is it fair to assume barring any sort of meltdown in global GDP and the like that the earnings contribution from the mineral sands side of the operation in 2019 will be higher than 2018? So that's one part of it. And then secondly, let's assume for a second that this inventory de-stocking on TiO2 is done and dusted as we go through the seasonally stronger period next year. And in that environment, in a higher sort of ore pricing environment, would that not provide sort of a landscape for higher TiO2 prices as well?

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

A

I think the answer to probably both of your questions, the simple answer is yes. Clearly, the mineral sands contribution to our overall profitability as an integrated producer will be higher during that period of time as others in the space see compression will benefit from our vertical integration. And that relative contribution will – although we manage this business as one integrated business, the relative contribution does change a bit during certain market conditions.

And then secondly, I think as John said in his comments a little bit I think, we believe that the return to more normal inventory levels and the elimination of de-stocking it's kind of when over the next few quarters. And I think as that plays out and we move into what is traditionally a stronger period of the year with typical seasonality, I think it does create a strong environment in which supply-demand being better balanced may lead to a more favorable pricing environment.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Understood. And as a follow-up, Jeff, obviously valuations in share prices across the space have come down tremendously. And I think as I talked to a variety of investors, the hangover from call it 2012 to 2016 is sort of fresh in their minds as well. It also started with pricing going up, the downturn of 2012 to 2016, pricing going up, the inventory bloated nature thing sort of caught a lot of people by surprise. What gives you guys confidence that this time around it's different? And again I'm not looking for a sort of global GDP or economic forecast, but just looking at it through the lens of TiO2, looking at it through the lens of what you see in your inventory level, customer inventory levels, because some of the chatter is the same, right? I mean, coatings volumes aren't great, some of the coatings companies are talking about conservation and the like, so I would love to hear your views about what may be different this time around.

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

Yeah. And we believe as a company that it is very different this time around. When you go back and look at sort of 2012, there were a number of factors that just aren't present right now. You had the fact that in the 2011-2012 timeframe that the price of 1 million tons of Chinese capacity had been brought on, you had the fact that there was significant feedstock capacity that had been added leading up to that period, you had sort of significant double-digit global demand declines and you had a pricing level that was way above anything we're talking about now where you reached $4,000 levels versus the current level which is – was about $1,000 a ton less. I think now as you look back at it, you look at 2018, capacity is generally flat with some sulphate closures expected and some moderate core capacity increases. You see not a lot of new expansion projects being on the drawing board to come online and the quality of those new projects may be somewhat declining.

You see modest demand declines rather than the double-digit type declines we saw in 2012 with the U.S. market being very, very stable and you see in your probably inventory levels just in general not being near what they were as you went into the 2011, 2012 timeframe. So we do think that the situation is much different. It's – this is always going to be a cyclical industry that has little – some topsy-turvy movement but overall the industry structure and some of the other things going on we believe will contribute to more modest volatility compared to what we saw before.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC
Q

Very helpful, Jeff. Thanks so much.

Operator: Thank you. Our next question is from Matthew DeYoe with Vertical Research Partners. Your line is open.

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

Good morning, gentlemen. I think in the past you stated more normal pigment inventory balances of like 30 or 40 days or I guess four to seven weeks, something like that. But the color I've received puts inventory balances closer on a global basis to like mid-50s as of the end of 2Q on a days basis. Where do you see global balances at the end of 3Q? And do you have any read on inventory balances by geography? I mean, anecdotally it sounds like Asia and Europe were higher which makes sense given price pressure, but if it's mid-50s globally, what was it in Asia and Europe versus where was it in North America where presumably it will be lower?

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

So when we think about our inventory, it is global and we don't typically break it out by region. We're trying to keep our inventories suitable to meet our customer demand in every region. So the numbers that you're referring to at the end of Q3 are not far [ph] taking off (00:53:56) from where we are at this particular stage. The 30- to 40-day number that you referenced earlier kind of goes back to the comment I made earlier going into 2018, we were below seasonal norms and we're getting back up into that seasonal norm range and would expect to exit 2018 at about that range.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

Okay. And then, I'm not certain if you'll be able to answer this, but can you talk a little bit about potential tax hit on the sale of Ashtabula and whether you'd be able to use your domestic NOL balance to offset all of it, most of it? What's the thought there?

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

A

Hey, Matthew, it's Tim. Just given the structure that we're looking at from a stock sale standpoint, we don't anticipate any negative tax consequences from that transaction.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

Perfect. Thank you, gentlemen.

Operator: Thank you. Our next question is from John Roberts with UBS. Your line is open.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. I understand there might be some recoveries [ph] at your sand (00:55:03) from their E&C providers. Does your loans to them have recourse to that or you're comfortable with the credit quality there that there's no risk to the loans even if they don't get recoveries?

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

A

John, I don't think it would be appropriate for us to speculate on recoveries and that's absolutely a [ph] Tasnee AMIC (00:55:25) type issue, but we are and remain confident of the recovery of our loan balances at this point.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. And I apologize I jumped on late, did you comment on whether you've been able to move significant volume into longer-term contracts with some price stabilization in them?

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

A

John, you want to address that?

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

A

Yeah. Look, as we mentioned on the last call, we're working collaboratively with our customers on margin stability initiatives that are designed to minimize the volatility and pricing. And quite frankly, as we move into the fourth quarter we believe that those initiatives are going to do just that. To the extent we actually can migrate to more of our volume on that as we close the transaction we'll be migrating in that direction.

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

A

Yeah. And John, I think it's fair to say that some of the progress that we will have in that has probably been deferred a little bit as we've gone through this final stage of the Cristal process, because obviously with some of these big customers, our presence of those customers changes pretty dramatically depending upon the closing of the Cristal transaction and what was included and what's not included and that type of thing. So, as you can imagine some of those longer-term stabilization features are a little bit easier to work out once you really understand what your full presence at a customer will be.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. Thank you.

Operator: Thank you. Our next question is from Christopher Perrella with Bloomberg Intelligence. Your line is open.

Chris Silvio Perrella
Analyst, Bloomberg LP (Research)

Q

Good morning. A quick one. Is there anything that would preclude you from buying shares directly from Exxaro down the road? And would that be impacted by or facilitated by the redomiciling to the UK?

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

A

Christopher, a great question. That absolutely is facilitated by the redomiciling. Under Australian law, there are significant limitations on share buybacks in general. And as we said as in the days to come, we hope to be able to give you an update on our discussions with Exxaro as well as the redomiciling transaction and those two are related and intertwined.

Chris Silvio Perrella
Analyst, Bloomberg LP (Research)

Q

All right. And then pending the Exxaro and maybe this is one for the Investor Day, would any of that change in the Exxaro holding, change the BEE requirements for the operations in South Africa?

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

A

No, Christopher, it wouldn't. And that again kind of relates back to JF's comments earlier about the new mining charter and the whole finalization for once and for all of that kind of once empowered, always empowered issue. And obviously until that happens, Exxaro has an obligation continuing for a number of years still to ensure that we're [ph] empowering (00:58:38). But we will definitely address that fully at the Investor Day because that is sort of a long-term strategic issue in South Africa, especially as we look at development of new resources there and new projects continuing to be BEE-certified will be important for us as we move forward there and we continue to plan on being a significant presence in South Africa for some time to come.

Chris Silvio Perrella
Analyst, Bloomberg LP (Research)

Q

All right. Thank you very much. That was it on my questions.

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

A

Thank you.

Operator: Thank you. Our last question is from Karl Blunden with Goldman Sachs. Your line is open.

Karl Blunden
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Thanks lot for taking the question. One of your peers had commented on price stabilization contracts reaching 50% a little bit above that of their portfolio. Is there any color you can give us on how far along you are now and where you'd ultimately like to get to?

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

A

You know I think I made a reference on the last call that our goal would be to get to somewhere in the range of 50% in 2019. But to the point that I made on the last question as well as Jeff's comments because of where we are with the transaction and the fact that we haven't closed yet some of those negotiations with customers are a bit delayed more so than we would have expected. So we're working towards that, those stability initiatives are in place kind of as an add-on to our value proposition and they're designed to help us grow with our customers so as soon as we close that transaction, which is to Jeff's point in the coming days, we will have an opportunity to start working on that, I guess, on a more wholesome way.

Karl Blunden
Analyst, Goldman Sachs & Co. LLC

Q

That's all understandable. In terms of length of the contracts as you've kind of seen and had discussions so far with customers, what's a typical or target length to think about?

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

A

Three to five years.

Karl Blunden
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks very much.

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

A

Thanks, Karl.

Operator: Thank you. And that does conclude our Q&A session for today. I'd like to turn the call back over to Mr. Jeff Quinn for any further remarks.

Jeff N. Quinn

President, Chief Executive Officer & Director, Tronox Ltd.

Thanks, Christie. I would just like to conclude today by saying a thank you and that's a thank you to my colleagues here at Tronox and our future colleagues at Cristal. It's been a long process, but the dedication and the focus that the collective employee group has shown has truly been extraordinary and inspirational. Our employees have continued to operate the business professionally and in a safe manner. You have my sincere gratitude and appreciation for that and also my thanks to the respective leadership teams of the two organizations for the tenacity and the perseverance that they've shown during these many, many months.

As we enter the holiday season, the end of the year, the end of this transaction process, I just urge our colleagues around the world to continue to operate safely and to really focus on each and every day because that's the most important thing.

So, thank you very much for your time today, your continued interest in Tronox. This ends our call, but we look forward to reporting progress to you in the coming days as well as speaking with you next quarter. Thank you very much and have a good day.

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