10-May-2018

Tronox Ltd. (TROX)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to Tronox Limited First 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 be given at that time. [Operator Instructions] And as a reminder, this conference is being recorded.

I'd now like turn the conference over to Brennen Arndt, Senior Vice President, Investor Relations. Sir?

Brennen Arndt

Senior Vice President-Investor Relations, Tronox Ltd.

Thank you, James, and welcome everyone to Tronox Limited's first 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.

A reminder that our discussion today will include certain statements that are forward-looking and subject to various risks and uncertainties, including but not limited to specific factors summarized in our SEC filings including 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, free cash flow and adjusted earnings per diluted share. Reconciliations to their nearest U.S. GAAP terms are provided both in our earnings release and in 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, and good morning to all of you. I'm going to start this morning by making a few comments about the general status of things, and then I'll turn it over to the team. JF and John and Tim will talk about our strong first quarter.

I'll begin with a few remarks on the significant progress we made over the last several weeks towards closing the Cristal acquisition. First, as a result of our discussions with the European Commission through the formal hearing process and the follow-on state-of-play meetings, we've narrowed the issues, and obtaining a conditional clearance from the Commission is now only dependent upon finalizing an agreement on the proposed remedy to address the remaining objection. Those discussions are ongoing on a real-time basis. We're also negotiating with multiple potential counterparties regarding execution of the proposed remedy.

Understandably, we received many questions about the overall timing in the EU. Under the current schedule, we are aiming to agree to all of the details on the remedy with the Commission staff, and by May 16, at which time that remedy will be formally submitted. Assuming we are successful, the staff would then market test the remedy and if the remedy checks out, the remedy would then be presented to the full commission for its approval.

Under the EU rules, the deadline for approval by the full commission is July 12. Since the submittal of the remedy to staff is confidential, we will not be able to provide any additional information on our progress until the remedy is approved by the full commission in a number of weeks.

In the U.S., we filed a motion with the FTC on Monday seeking to stay the administrative proceedings scheduled to start on May 18. The motion is publicly available and we've posted a copy on our website. If granted, the stay would allow direct discussions with the FTC Commissioners, something not permitted while the administrative process is pending. If those direct discussions don't result in a resolution of the matter, we will ask the FTC Commissioners in the alternative to consider pursuing the FTC's case through the typical Federal Court process, which is much more likely to result in a timely resolution.

Two weeks ago, the U.S. Senate confirmed a full slate of five new Commissioners to the FTC. Prior to their confirmations, The FTC had been operating with only two Commissioners. Four of the five new Commissioners began their service last week. The fifth new Commissioner will replace the outgoing FTC chairperson who was awaiting Senate confirmation as a judge on the U.S. Court of Federal Claims.

While the synergies of the acquisition related to the U.S. plants are less than those outside the U.S., there is significant value to be derived from the ownership and operation of the U.S. Cristal assets. Clearly, for the long term, by owning these assets we are a stronger, better positioned and more competitive pigment producer across the cycle in a global market with strong global competitors including the Chinese producers. Owning these assets allows us to more fully meet the demands of our global customer base, to enhance our vertical integration strategy, and to enhance our competitiveness globally. We look forward to reaching a resolution and moving on to the real business of creating the premier TiO2 company in the industry.

We share your impatience for getting this deal done. We, like perhaps some of you, are perplexed that our share price does not appear to reflect a risk-adjusted assumption that this deal will get done. Let me reiterate, as we have stated many times in the past, our firm belief is that the deal will get done. Our goal has always been to reach an appropriate and proportionate resolution to address any valid regulatory concerns and to do so as quickly as reasonably possible. I believe we are making progress towards this goal.

While we continue to work hard at securing regulatory approvals, we also continue our integration planning work to ensure that we hit the ground running on day one following the closing of the acquisition.

As part of that planning, we announced last night the entry into a Technical Services Agreement and an Option Agreement with the Advanced Metal Industries Cluster Company, otherwise known as AMIC, an entity owned by Cristal and Tasnee with regard to the titanium slag smelter facility located in Jazan, Saudi Arabia.

The Jazan slagger will enable us to further optimize across the cycle and over the long term the level of vertical integration between our pigment and feedstock operations, following the close of the Cristal merger. We will combine our slagger operations expertise with that of AMIC under the Technical Services Agreement to work together to ensure the successful commissioning of this world-class smelter facility.

The slagger has the capacity to support up to 500,000 metric tons of titanium slag and 220,000 metric tons of pig iron and will become a low cost source of feedstock for the 11 pigment plants in the combined company.

As part of the Option Agreement, AMIC will create a special purpose vehicle, or SPV, incorporated in Saudi Arabia. AMIC will contribute its ownership interest, along with $322 million of debt that they currently hold.

When the merger with Cristal is completed, and provided that the slagger meets certain production criteria over a sustained period, we intend to exercise the option to acquire a 90% ownership interest in the SPV to support our long-term integrated feedstock plan.

We agreed to lend AMIC and the SPV up to $125 million for capital expenditures and the operational expenses to facilitate the startup of the slagger. These funds may be drawn down on a quarterly basis as needed, based upon a budget agreed upon by the company and AMIC.

The total consideration payable by Tronox will consist of the $125 million loan, the effective assumption of the AMIC debt through the ownership of the SPV, and an adjustment for working capital, cash and debt. In addition, Tronox and AMIC have agreed to enter into a shareholder agreement relating to our respective rights and obligations as shareholders of the SPV.

The next topic I'd like to briefly mention is an update on Exxaro and the reaffirmation of their intent to monetize a portion or all of their remaining Tronox shares.

You will recall that last October, Exxaro sold 22.4 million shares in an underwritten registered offering, reducing their ownership of the company from 44% to 24%. A couple weeks ago, Exxaro started the process to monetize up to the balance of their holdings by announcing the commencement of shareholder voting to obtain the approvals necessary to sell their remaining Tronox shares at a future time.

This is only the first step in that process. The shareholder voting concludes with a general meeting currently scheduled to occur on May 24. No decision has been made by Exxaro as to the timing of any actual potential offering. We continue to dialogue with our colleagues from Exxaro on those issues.

Moving to our first quarter results. Our strong top and bottom line performance in the quarter clearly reflected the benefits of our vertical integration strategy. Our TiO2 business delivered revenue growth of 17%, adjusted EBITDA growth of 62%, and adjusted EBITDA margin of 31%, and free cash flow of $52 million.

Our pigment, feedstock, and co-products operations all performed very well and continue to benefit from favorable market conditions across the value chain.

Our strong top and bottom line results were delivered despite the effects of the timing of large shipments for feedstock and co-products that skewed some of the quarter-versus-quarter comparisons that many of you track. This is not a reflection of a softening of market conditions. The reality is just the opposite. We are seeing strengthening in feedstock and co-products markets, such as zircon and pig iron, and expect these favorable trends to continue across the year.

Our strong first quarter results were also impacted by foreign exchange headwinds, primarily related to the rapid strengthening of the South African rand relative to the U.S. dollar during the quarter. The rand appreciated 12% against the dollar from the fourth quarter of 2017 to the first quarter of 2018, triggered by the recent political changes in South Africa.

Despite the short-term impacts, these political changes bode well for the future of our South African operations. The rand-dollar relationship now appears to be stabilizing as approximately one-half of that first quarter headwind has been recovered thus far in the second quarter.

I'll turn the call over now to Jean-François and to John for a review of the commercial and operational performance in the TiO2 business in the first quarter, including a more thorough discussion of the transient impacts of shipment timing and the FX issue. First will be John Romano, our Chief Commercial Officer. 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 first quarter compared to the year-ago first quarter. TiO2 segment revenue of $442 increased 17% driven primarily by higher selling prices for pigment, zircon and pig iron.

Pigment sales of $333 million increased 22% as average selling prices increased 25% or 20% on a local currency basis, while sales volumes were 2% lower due to inventory availability related to the timing of plant maintenance. Pigment sales prices were higher in all regions. Titanium feedstock and co-products sales of $97 million increased 5% from the year-ago quarter.

Favorable market conditions continue in titanium feedstock and co- products as selling prices increased 34%. Sales volumes were 22% percent lower, reflecting the timing of shipments for zircon and chloride-process titanium slag. Zircon sales of $61 million increased 22% driven by 52% higher selling prices, which more than offset the 20% lower sales volumes as shipments originally scheduled in the first quarter occurred in the prior quarter.

Pig iron sales of $19 million increased 73% as selling prices increased 18% and sales volumes increased 41%. Feedstock and other products sales at $17 million were 45% lower driven by the timing of shipments. There were no sales of chloride-process titanium slag in the first quarter compared to $12 million of sales in the year-ago quarter.

Moving to slide 5 for the sequential comparison versus last year's fourth quarter. TiO2 segment revenue was 5% lower despite higher selling prices for pigment and across all major product lines in feedstock and co-products. The revenue decline was largely driven by lower sales volume of zircon, pig iron and chloride-process titanium slag, again due to the timing of shipments.

In our fourth quarter call, we spoke about a high level of shipments for feedstock and co-products that occurred in that quarter. We were successful in making several shipments earlier than expected that generated approximately $20 million of revenue and approximately $7 million to $8 million of associated EBITDA. In addition, some shipments originally scheduled for the fourth quarter have now moved into the second quarter.

As Jeff said previously, the impact of the timing of shipments is not in any way an indicator of softening market conditions given the tight supply/demand conditions and pricing momentums we're seeing in this market. We realized sequentially higher selling prices across all product lines. Our feedstock and co-products business is a bit different than our TiO2 business in that we routinely make much larger shipments in bulk that can and will continue to be influenced by port congestion, primarily in the port of Richards Bay in South Africa. We expect this part of the business will continue to strengthen as we have more opportunities to sell feedstock and co-products than we have inventory to support those opportunities at this time.

Pigment sales of $333 million increased 5% from $316 million in the prior quarter, as prices increased 3% or 2% on a local currency basis and sales volumes increased 2%. Though feedstock and co-products markets continued to strengthen in the quarter, titanium feedstock and co-products sales of $97 million decreased 27%, reflecting lower zircon, pig iron and chloride-process titanium slag volumes resulting from the timing of shipments.

Zircon sales of $61 million were 9% lower as selling prices increased 12% which were offset by 19% lower sales volume, again, due to shipment timing. Pig iron sales of $19 million were 5% lower as 12% higher selling prices were offset by 16% lower sales volumes, again, due to shipment timing. Feedstock and other products of $17 million were 63% lower driven by shipment timing. There were no sales of chloride-process slag in the quarter compared to $12 million of sales in the prior quarter.

In the second quarter, we're expecting sequential growth in pigment sales and double-digit sequential growth in zircon and pig iron sales driven by healthy demand and the timing of planned shipments as we have completed a shipment of CP slag in the second quarter. As we look across the year, we see these favorable market conditions continuing. And with a view that extends beyond the next couple of quarters, we are working proactively with our customers with the intent to stabilize the volatility of our margins so that we can continue to reinvest in the business across the cycle.

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 metrics. JF?

Jean-François Turgeon

Executive Vice President and Chief Operating Officer, Tronox Ltd.

Thanks, John. I'll start by mentioning that our mine and plant are operating at full capacity to serve strong demand for pigment, feedstock, and co-product. In fact, our pigment plant achieved record production in March. I want to take the opportunity to thank all of our employees for their good work that made this happen. All our plants are performing well and focused on producing safe, quality, low-cost ton for our customer, our guiding principle across all our global TiO2 business.

Let's first look at our EBITDA performance in the first quarter compared to the year-ago quarter. TiO2 segment adjusted EBITDA of $138 million increased 62% from $85 million in the year-ago quarter, driven largely by higher selling price for pigment and across all major product line in feedstock and co-product. The strong top line performance was partially offset by unfavorable foreign exchange on costs, principally the South African rand as well as modestly higher operating costs.

Moving to the sequential comparison versus the fourth quarter, adjusted EBITDA of $138 million was 12% lower than $156 million in the fourth quarter. As John reported, we benefit from higher selling price in both pigment and feedstock and co-product relative to the fourth quarter. But more than offsetting those price gain were the impact of shipment timing and the foreign exchange headwind on costs, again principally the rand and, to a lesser extent, the Aussie dollar. As Jeff mentioned, the rand appreciate 12% against the U.S. dollar from the fourth quarter of 2017 to the first quarter of 2018, driven by the recent political change in South Africa, change that bodes well for our South African operation. Since then, the rand-dollar relationship appeared to be stabilizing as approximately half of the headwind has been recovered so far in the second quarter.

And despite those FX headwind and lower shipment of high-margin co-product, our adjusted EBITDA margin was 31% in the quarter. In my view, this is a clear reflection on the benefit of our vertical integration with all our asset in full operation. My team and I continue to drive our very successful Operational Excellence program to work to offset the impact of foreign exchange and inflationary pressure, much the same way we overcame them in 2015, 2016, and 2017. We have a pipeline of more than $70 million of cost reduction project that will continue to improve the cost per ton of our product. In addition, our acquisition integration planning works is well advanced. We are busy planning for the deployment of the Operational Excellence program across the combined Cristal and Tronox asset. This will allow us to quickly deliver on the synergy as soon as we close the transaction.

A comment on the drought conditions that are affecting the Western Cape of South Africa, including our Namakwa Sand (sic) [Namakwa Sands] (00:23:46) mine and smelter. True, the condition has been severe, we have managed through them without significant impact to our operation. We benefit from the strong support we receive from the community and the local authority around our operation. In addition, we implemented contingency plan that include the purchase of a desalination plant that is scheduled to be operational in August 2018. This should further minimize the impact on our operation, while allowing us to continue to produce without interruption.

TiO2 continue to deliver strong free cash flow. We generate free cash flow of $52 million in the first quarter, as cash provided by operating activity was $79 million and capital expenditure were $27 million.

With that, I thank you, and I'll 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, JF. Moving to slide 7. On March 31, 2018, growth consolidated debt net of debt issuance cost was $3.15 billion; and debt, net of cash and cash equivalents, was $1.42 billion, including $653 million of restricted cash for the Cristal transaction. Liquidity was $2.03 billion comprised of cash and cash equivalents and $1.73 billion, including the restricted cash for the Cristal acquisition, and $305 million available under revolving credit agreements. Our blended cost of debt was 5.82% in the first quarter and on March 31, 2018, 33% of our total indebtedness was set at a fixed rate.

On April 6, we completed a private placement offering of 6.5% senior notes due in 2026 for an aggregate principal amount of $615 million. We used the net proceeds to fund the redemption of $584 million aggregate principal of 7.5% senior notes that were due in 2022.

We expect cash interest expense net of interest income for the full year 2018 to be approximately $165 million, down from $170 million that we forecast in the last quarter's call.

Cash used in corporate operations was $83 million in the first quarter, which included a semi-annual bond interest payment of $22 million. As a result of our debt refinancing, these semi-annual bond interest payments will now be made in the second and fourth quarters each year rather than the first and third quarter.

Capital expenditures were $28 million in the quarter, and depreciation, depletion, and amortization expense was $48 million. We are reaffirming our expectations for capital spending, DD&A, and cash tax in 2018 with capital spending of $120 million to $130 million, DD&A of $180 million to $200 million, cash tax of approximately $20 million. Each of these estimates is on a Tronox stand-alone 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.

Yes. Thanks, Tim. And now turning to slide 8, I'd like to share some perspectives on 2018 and summarize the key points we'd like you to take away from this morning's call.

First, we've made significant progress over the last several weeks towards closing the Cristal acquisition. As a result of our discussions with the European Commission through the formal hearing process and the follow-on state-of-play meetings, we've narrowed the issues, and obtaining a conditional clearance from the EU is now only dependent upon finalizing an agreement on the proposed remedy to address their remaining objection.

We are also negotiating with multiple potential counterparties regarding execution of the contemplated remedial transaction. Under the current schedule, we are aiming to agree on all of the details regarding the remedy by May 16 with the commission staff and then formally submit the remedy.

Assuming we are successful, the staff would then market test the remedy, and if the remedy checks out, the remedy would then be presented to the full commission for its approval.

Under the EU rules, the deadline for approval by the full commission is July 12. Since the submission of the remedy to the staff is confidential, we will not be able to provide any additional information on our progress until the remedy is approved by the full commission.

In the U.S., we filed a motion with the FTC this week to seek a stay of the administrative proceeding that is scheduled to begin on May 18. If granted, the stay would allow us to engage in direct discussions with the new Commissioners, something not permitted while the administrative process is pending.

If those discussions don't result in a resolution, we will ask the FTC Commissioners in the alternative to consider pursuing the FTC's case through the typical Federal Court process, which is much more likely to result in a timely resolution.

We are focused on creating the most value as possible for our shareholders and our customers. Our goal has always been to reach an appropriate and proportionate resolution to any regulatory concerns and to do so as quickly as reasonably possible. As I said earlier, I believe we have made progress in this regard.

Second, we're confident that 2018 will be another year of strong performance for our company. We see the momentum continuing in our TiO_2 business across the balance of the year, driven by tight supply demand balances globally across the entire value chain of our business.

We believe that pigment inventories in aggregate remain at or below normal levels across the industry. We also believe pigment producers globally continue to run at high utilization rates, including the Chinese producers. Our challenge and our mission is to take care of our own business to continue our strong operating performance and servicing our global customer base.

As John said a few minutes ago, we are working proactively with our customers with the intent to stabilize the volatility of our margins across the cycle, so that we can continue to reinvest in the business across that cycle. But with the additional intent of providing value to our customers by stabilizing the prices which – and removing the spikes and the valleys, which will create value for them and allow them to better plan their business.

We see continued tightening conditions in feedstock and co-products, zircon and pig iron. As a fully integrated producer, we expect to continue to benefit from rising margins at both feedstock and pigment levels.

And third, 2018 will be a year of transformation. Our acquisition integration planning work is very advanced. We expect to hit the ground running on day one following the close of the acquisition to enable us to quickly deliver on the synergies.

Both Tronox and Cristal continue to perform well. In last quarter's call, our estimate of the 2018 pro-forma EBITDA was $950 million to $1 billion without synergies. With the benefit of our first quarter results and those of Cristal, we are revising upward our estimates for 2018 pro forma EBITDA to be between $1.0 billion and $1.1 billion, again, before synergies. We expect year-one synergies of $100 million.

As you have heard us consistently, since the day we announced the transaction, this highly synergistic, pro-competitive combination is all about increasing asset utilization, lowering our cost position, unlocking incremental product volumes to serve growing markets worldwide and generating strong cash flow. That strong cash flow will facilitate investment in our assets across the cycle to better serve our global customer base. Our goal remains unchanged; that is to create the world's premier TiO2 company for our investors, for our customers and for our employees.

With that, I thank you, and now like to open the call for questions.

QUESTION AND ANSWER SECTION

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

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

Q

Yes. Good morning and thanks for taking my question. A couple of, I guess, points. I guess when you're thinking about the optionality around the slagger, I guess how should we be thinking about the synergy potential tied to that when you can bring that kind of to your fuller platform?

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

A

Well, Rob, I'd say that the most important thing there is that the slagger will allow us to continue to operate our mineral sands operations at full capacity and it will be a significant source of demand for the mineral sands, as well as producing significant volumes of high-value feedstocks. JF?

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

A

Yes. I think that our pigment plant generates less waste when we use a high-grade feedstock, and we obtain co-product, the pig iron that generate as we upgrade the ilmenite into slag is a source of revenue as well for the business.

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

Q

I guess can you quantify what the benefit would be say on a normalized basis or in this current environment just to give us a little bit of color?

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

A

No, John, but I would say that in the press release and in the script, we talked about the nameplate capacity of Jazan, both from feedstock as well as a pig iron standpoint. It's a world-class smelter that if we can get to run at or near full utilization, it will be a significantly low-cost supplier to our feedstock operation, a competitive advantage in that regard. So, that plus the merchant sales at pig iron, it's a very economically attractive move for us.

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

Q

Great. Okay. No, appreciate that. And then I guess on the EC remedy, I know you can't get into too much in terms of details, but I guess can you quantify what you think the impact would be in terms of your synergy opportunities from the transaction? It sounds like it would be relatively minimal, but I guess if you can give us some color on that, that would be helpful.

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

A

Yes. I believe any impact on the synergies for the remedy would be very minimal, if any at all.

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

Q

Great. And then maybe just one last question, we've gotten a lot of feedback from your peers on the pigment side and on the ore side in terms of how things are tightening up. And I guess as you look into 2018 and maybe even 2019, I guess how do you think about the two relative platforms that you've got and how to think about the tightening overall? I mean, do you see pigments tightening up more than ores? Ore is kind of catching up to the pigments over the next 12 to 18 months. I guess how should we be thinking about that balance and the benefit that it gives you being fully integrated like that?

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

A

Yes. This is John Romano. So, on the feedstock and co-products, as I mentioned kind of in the script, we're seeing more demand for feedstock and co-products than we currently have inventory to support those opportunities. So, we're going to continue to see, I would say, strong demand growth in that area. For us, that's a good thing because the high-grade feedstock, we're seeing prices of that product moving up and we're continuing to internalize more of the natural rutile that we have to feed our own plants.

As far as the TiO_2 market goes, we're continuing to see steady demand in all regions. We don't typically provide a forward look on pricing, but I would say moving into Q2 and Q3 we're going to continue to see moderate appreciation on price.

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

Q

Great. Thanks very much for the color.

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

A

Thanks, John.

Operator: Our next question comes from Frank Mitsch with Wells Fargo. Your line is now open.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

Yes. Good morning, gentlemen. Jeff, I have a question on timing. I don't have a great sense as to how long it takes FTC Commissioners to get up to speed particularly with your transaction. So, I was wondering – because you said that you're going to engage in direct dialogue and then at that point if it's not satisfactory, you'll ask them to go into the typical Federal Court process. What would that timeline look like for you to get to the point where you think you might have to ask to get into the Federal Court process?

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

A

So, I think as you know, Frank, the administrative hearing is scheduled to begin on May 18. If the FTC were to not grant our stay, that hearing would continue forward. And through the trial process and the period of time after trial that the ALJ has to render a decision, et cetera, et cetera. That would not provide a final – a decision until much later in the year and probably not in a timeframe that is relevant to the transaction.

If our discussions with the FTC were not allowed or don't result in a resolution but we were able to persuade the FTC to go the typical Federal Court route, that Federal Court process would take somewhere around four to five months from the point it was filed.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

Okay. So, if you don't get a resolution – and so my, I guess, a follow-up, I mean are you in discussions with the FTC? Here we stand on May 10, I guess it is. Is that something, a June event? Is that a July event that you would get to that point where you say, okay, let's go to the Federal Court process? Or is that the sort of timeframe we should be thinking, 1 month or 2 months type of timeframe?

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

A

Well, I think there is no specific timeline for the FTC to act on our motion for a stay once that issue or that motion is sort of certified to the Commissioners by the ALJ. I think certainly, the European Union timeframe is relevant there because of the early July deadline for a final decision in the EU, assuming that – as we believe it will and hope it will – things continue to go well there. If we receive the conditional approval at that point in early July, we would be able to close the transaction if the FTC did not move to the Federal Court venue to try to obtain a temporary restraining order and a PI. So, that early July timeframe we believe is very relevant. It would be our hope that we're able to engage in meaningful discussions with the FTC well in advance of that timeframe so that once the EU situation is resolved, we would be good to go.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

All right. That's helpful. And then just a housekeeping question, you discussed that the South African rand appreciated 12% relative to the dollar, so that had a negative impact in Q1 although based on where trends are now, half of that negative impact is going to be realized in Q2. What was the order of magnitude of negative impacts roughly that the rand was to your Q1 results?

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

A

The rand itself in Q1 was about the $12 million to $13 million on cost and another $6 million on translation on receivables.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

So, altogether close to $20 million negative impact?

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

A

About $18 million in the quarter, correct. And we should see half of that come back in Q2 given current rates. And the Aussie dollar has also changed in our favor as well. We should see $3 million or $4 million from the Aussie dollar come back in Q2 as well as – sequential Q1 to Q2.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

Terrific. Thank you so much.

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

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

A

Hi, Hassan.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Good morning. How are you doing?

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

A

Very good. Thank you.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

A question – obviously, cognizant of the fact that you can't sort of disclose too much with regards to the European Commission discussions and the like. But broad stroke, was just trying to get a sense in terms of just remedy, I mean are we talking sort of asset disposal? Are we talking sort of walking away from certain customers, clients? Are we talking sort of providing some technology to competitors? I mean broad-brush, how should we be thinking about it?

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

A

The scope of the remedy is something that we believe is – will not have a significant impact on the value creation opportunities. It is something that would be designed to maintain the competitive balance the commission believes is so important in the relevant markets that have been identified as being problematic, and it would not have a significant impact on our ability to realize the synergies from the transaction.

Beyond that, I'm very reluctant to say more because I just don't want to get out ahead of the Commission at all and because of the confidentiality requirements. But it's something that obviously we're very pleased with and optimistic that we can conclude in the next number of days.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Understood. Understood. Now, moving to the pricing side specifically on the pigment side of things, some of the coatings companies basically reported earnings. They had some volume weakness. They were citing, obviously, weather issues because of that volume weakness.

But as you take a look at their basket of raw materials, be it epoxies, be it propylene, be it TiO_2, I mean there's been significant inflation over there, but they're talking about – most of them are talking about increasing their pricing in the back half of the year to offset these sort of raw material price hikes.

So, I'm just trying to get a sense that with TiO_2 pricing, where it is right now, obviously significantly below levels where it was at in the past peak, what sort of discussions are you guys having? Are you in the camp of sort of talking about longer-term contracts? How amenable are the coatings companies to sort of giving you the pricing that you guys are requesting, keeping in mind the relatively snug supply-demand balances and the like?

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

A

Yes. This is John Romano. So, with regards to longer term pricing towards trying to take the volatility out of the market, as Jeff referenced and as did I, we're in various levels of discussion with a number of customers, some of which we've already concluded. We believe that's something that's healthy for our business and it's also healthy for our customers.

So, that's really where we're focused, and that's I would say – and not just in North America and not just in coatings, we're looking at that globally. And I would say there's varying levels of progress that we're making depending upon the region that we're working in.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Understood. Understood. Very helpful. And one final quick one, if I may. You mentioned the Exxaro stake sale. Just if you could remind me, are there any stake sale restrictions on Exxaro before the deal closes – before the Cristal deal closes?

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

A

No. I mean, not per se. But I think, obviously Exxaro would have to sell at period of time that – during a window or when there's no clarity on everything in the deal. So, no, I don't think there are restrictions per se. I certainly would expect that just as a practical economic matter, Exxaro would wait until there is clarity on the deal before considering to move forward. But obviously, that's their decision and we don't totally control that timing.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Very helpful. Thank you so much.

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

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Hey, guys. It's actually Mike Leithead on for Duffy this morning. I think you talked about your TiO2 plants running at full capacity in the slides. So if the market is expected to grow over, say, the next two, three years, are you dependent on the Cristal plant to fulfill incremental demand? Or is there debottlenecking capability at your existing plant base if we don't have the Cristal assets?

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

A

Mike, it's JF. Look, there is always some debottlenecking that we can do with our plants. Our Operational Excellence program has allowed us to increase the uptime of those facility, and we could probably grow at a slow pace. But there's obviously a huge upside on achieving the control of the Cristal asset, and part of the synergy is being able to grow with our customer by improving our capability to supply in that tight market by liberating the hidden factory of the Cristal asset. That's how we feel.

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

A

Yes. And, Mike, also it's not just the Cristal assets, but with the cash flow and the financial wherewithal that the combined company will have, that will even allow us to consider projects at the current legacy Tronox operations to be able to look for ways of debottlenecking and lowering costs and adding capacity along the way.

So it really is, we believe, a net-net very exponential increase in our ability to reduce cost and become more competitive to the benefit of our customers.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. That makes sense. And just a clarifying question, I think I heard you mention some shipments that were expected to land in 4Q are now expected to be in 2Q. Are those shipments that are pulled forward from 4Q 2018 or shipments that are pushed back from 4Q 2017?

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

A

No. I think actually John misspoke. I think it's actually shipments that were being pushed from first Q to second Q. I think John maybe misspoke during the...

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

A

We had a CP slag shipment that was supposed to go in Q1, as John mentioned, that went in Q2.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Got it. So...

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

A

So, we had – go ahead.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Sorry. No. So just to be clear, so there was some that was pulled forward from 1Q into 4Q, but there was also maybe some shipments that should have occurred in 1Q that are going to show up in 2Q. Is that fair?

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

A

Exactly. We're suffering a little bit from both directions, right? So it makes the first quarter look a little bit artificially weak on volumes when we [ph] had to move (00:49:51) some pre-shipments and some things delayed.

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

A

And specifically, one of those was a chloride slag shipment that has now shipped in Q2.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. That makes sense. Thank you.

Operator: Thank you.

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

A

Thanks, Mike.

Operator: Our next question comes from Matthew DeYoe with Vertical Research. Your line is now open.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

Morning, gentlemen.

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

A

Hi, Matthew.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

So in the past you kind of talked about parallel paths for U.S. FTC engagement. And I know where you stand or we now know where you stand with the FTC, but have you embarked at all on kind of discussions with potential acquirers on remedy packages or have indications of interest? Or does that all come once discussions start with the FTC more formally?

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

A

As we've said, we are embarked on a parallel path process, and we have continued to advance both parallel paths there in that regard. So those processes are started and continue as we speak.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

Okay. And then if I might dig in a little bit more on the mineral sand side of things, can you talk about trends in rutile slag and ilmenite prices both year-over-year and sequentially, kind of how much – how they continue to appreciate?

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

A

We can't get too specific about how much, but on all of those we're seeing price move up. Again, at this particular stage, we're not selling as much high-grade feedstock as we would have historically, because we're internalizing a lot of that. But what we are selling, we're seeing prices move as well as in zircon, natural rutile and pig iron.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

Okay. Then on the internalization of the higher quality side of things. I mean you mentioned you're starting to increasingly benefit from the vertical integration. Can you provide a little bit more color around the quantification of that? Yes.

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

A

Well, maybe the point we can say is that the value of the vertical integration really shows when you see the feedstock side of the TiO2 business moving up in price. Because in our case, we continue to deploy our Operational Excellence program, and we're actually lowering the costs of making that feedstock, and it's the margin that we absorb both on the mineral sands side and on the pigment. So that's really where you see the strength. And that's really the differentiator of Tronox versus its competitor. Because being fully integrated, I mean, we see no impact as the feedstock price is moving up.

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

A

And I would add that – we can't give you the numbers obviously per se. It's a competitive advantage for us.

But I think that advantage is reflected in our – in the segment's adjusted EBITDA margin improvement over the last year or so. I mean, even in this quarter, despite the absence of high-margin zircon and pig iron and some of the other shipments, the segment delivered a 31% EBITDA margin.

So I think that's a – it's a pretty clear reflection of the mineral sands assets, as well as the pigment assets running in full utilization, absorbing that high fixed cost very well.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

Q

Okay. Makes sense. I appreciate it.

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

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. I think you said local currency pricing for TiO2 was up 2% sequentially first quarter versus fourth quarter. And that would be a mix of regions and large versus small customers and specialty versus basic. Was pricing up sequentially in basically all regions and customer types, or could you give us a sense maybe of any deviations from that average 2%?

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

A

Yes. We saw price appreciation across all regions with the exception of – and Latin America was flat. We had no price deterioration there, but we didn't implement a price increase in Q1. We had one that was announced for Q2 so we were going through the process of implementing that increase during the latter part of Q1. So, again, it's moderate growth, but we're continuing to see price appreciation.

Operator: Thank you. Our next question comes from Brian Lalli with Barclays. Your line is now open.

Brian J. Lalli
Analyst, Barclays Capital, Inc.

Q

Hey, guys. Good morning. How are you?

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

A

Good. How are you?

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

A

Hey, Brian

Brian J. Lalli
Analyst, Barclays Capital, Inc.

Q

Hey. Good morning. I guess first on the balance sheet, Tim, I know you spoke about this a bit on the last call, but could you just recap how you'd handle the balance sheet under, I guess, the two scenarios? I guess, first, if the deal weren't to close, obviously, you have a lot of cash, could you just sort of walk through the anticipated repayments of that?

And then I guess secondly if you do close a deal but there are some remedies and potential things you have to do from a regulatory standpoint, anything that would maybe come in from an asset sale standpoint or proceeds? I guess, how would you walk through that from a repayment of loans or just resizing the balance sheet? That would be helpful color. I know you're still a few months away from figuring all this out but again that will be helpful color.

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

A

Thanks, Brian, for the question. If we did not close, but obviously we believe we will, the Blocked Borrower account would be liquidated, and that would be paid off, as well as $800 million from the Alkali proceeds from the term loan would have to be paid off. So, with those two payments, our debt ratio would be quite good still.

As it relates to any potential remedies and what the impact would be, as of now we've looked at a number of different options. We would repay some debt but there would also be opportunities for other capital allocation as it relates to dividend, maybe some share repurchase, and potentially something to bolt on in China or from a mineral sands standpoint.

Brian J. Lalli
Analyst, Barclays Capital, Inc.

Q

Got it. Just a quick follow-up on that [ph] you (00:56:33) talked about two to three times. Can I just I guess confirm is that something you think about ultimately on a gross basis, again, as you kind of get back to a more reasonable balance sheet through a cycle?

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

A

Yes. I see a growth and that actually being very close to one another as a result of our cash management approach. That target is still our internal target.

Brian J. Lalli
Analyst, Barclays Capital, Inc.

Q

Cool. And then my last one, and again maybe I've missed this and I apologize, but could you just I guess give us a sense for what your guidance was before? Again, I apologize if I've missed it, but I guess I wasn't sure what your number was previously. I think I've seen a number that was $1 billion. I thought that was inclusive of some synergies. So, again just to sort of make sure I understand how you guys have thought about this increase...

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

A

Yes, Brian, the...

Brian J. Lalli
Analyst, Barclays Capital, Inc.

Q

Yes, go ahead.

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

...yes, the previous guidance was $950 million to $1 billion without synergies, and now we're taking that to $1 billion to $1.1 billion without synergies. And we've been consistent on expecting $100 million of synergies in year one.

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

And then the only change that we've talked about, Brian, as it relates to free cash coming from that, there's about $75 million associated with the slagger this year, $125 million total over an 18-month period, but still $400 million to $500 million.

Brian J. Lalli
Analyst, Barclays Capital, Inc.
Q

Understood. Yes, I wasn't sure where to go back and check that $950 million to $1 billion number, so that's helpful. Thanks, guys.

Operator: Thank you. Our next question comes from Wayne Cooperman with Cobalt Capital. Your line is now open.

Wayne Manning Cooperman
President, Cobalt Capital Management, Inc.
Q

So, just good timing. I was going to ask the question from before. Can you walk us through the increase in guidance pre-synergies? Is it coming from the Tronox side, the Cristal side? Anything in particular you could point to that increased the guidance?

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

Yes. Wayne, it's coming from both sides. Both companies are performing well from an operational standpoint, from a safety standpoint and benefiting from the tight market conditions. So, it actually comes from both. We obviously – the situation is developing and we continue to want to provide insight on a conservative basis in terms of what we see the pro forma company would look like. And we think that $1 billion to $1.1 billion is exactly that – a conservative statement of what the pro forma company would look like.

Wayne Manning Cooperman
President, Cobalt Capital Management, Inc.
Q

And that includes whatever you're expected remedies are to get the deal approved at this point?

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

Yes, it does.

Wayne Manning Cooperman
President, Cobalt Capital Management, Inc.
Q

Okay. Thanks.

Operator: Thank you. Our next question comes from James Hayter with Rossport. Your line is open.

James Hayter
Financial Analyst, Rossport Investments

Q

Hi, guys, and thanks for taking my questions. I just want to focus on the feedstock operations, if I may. Two questions. Firstly, did I hear you correctly in saying that all the excess inventory you had, particularly of ilmenite has been worked through? And has it been worked through as in turned into titanium slag for sale or has it been turned into titanium slag for sale and sold?

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

A

James, it's JF here. Look, maybe I did not express myself clearly, but we with the Jazan smelter, one of the synergy that we see is obviously to use the excess ilmenite that we have in our South-African operation. And I know that in the past Tom has talked about a huge pile of ilmenite that we have sitting on the ground in South Africa. Well, that ilmenite is still there and still sitting on the ground. So, I mean that's why we're very pleased with the announcement of this Option Agreement this morning because it will facilitate the synergy that we'll deliver out of the deal.

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

A

Yes. And that stockpile that's there is carried at zero value. So, obviously it's very profitable when we're able to actually process that.

James Hayter
Financial Analyst, Rossport Investments

Q

That's great, guys. I'm pleased that I asked, and thanks for clearing that up.

The second question relates to a question earlier regards to the split between what feedstock is – percentage of feedstock is sold externally, and what percentage is consumed internally. I know there are competitive reasons why you can't give us an exact number. But if I look at the TiO2 – the feedstock operations can produce around [ph] 700 to 750 (01:01:15) a year. And internally, you can produce around [ph] 465 (01:01:19). I know they're different types, but are they sort of broad brush numbers that I can work with and does that get me towards sort of number or am I just way out here if I use those numbers?

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

A

Typically, we don't, again, disclose exactly how much that we're selling on the open market. The majority of what we do sell is in fact, CP slag. We also sell some natural rutile but generically it's – I guess I'm just reluctant to give the exact numbers...

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

A

We've disclosed that the merchant side of the CP slag sales are under a longer-term contract. So, we're not playing in the merchant market per se...

[indiscernible] (01:02:07)

I'm sorry, yes, I was going to also say I think it's also fair to presume that given the tight market conditions in pigment and the need to make every ounce you can and the resulting demand for feedstock is that we're increasingly using our natural rutile in-house rather than selling it down into the merchant downstream markets.

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

A

And as we close the transaction, the feedstock that we are externally selling will be internalized.

James Hayter
Financial Analyst, Rossport Investments

Q

Guys, that's great. Thanks. Thanks for clearing both of those up. I appreciate it.

Operator: Thank you. [Operator Instructions] I show no further questions in queue, so I'd like to turn it back over to Mr. Quinn for closing remarks.

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

Thank you, James. Again, I want to thank each of you for being with us this morning and for your time and thank you for your continued interest in and support of Tronox. We look forward in the weeks to come for sharing additional updates with you about the progress we're making towards creating the world's leading global TiO2 producers. So, thank you very much, have a good day.

Operator: Thank you. Ladies and gentlemen, that does conclude today's conference. Thank you very for your participation. You may all disconnect. Have a wonderful day.