01-Mar-2018

Tronox Ltd. (TROX)

Q4 2017 Earnings Call

CORPORATE PARTICIPANTS

Brennen Arndt
Vice President-Investor Relations, Tronox Ltd.

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

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

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

OTHER PARTICIPANTS

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Michael J. Leithead
Analyst, Barclays Capital, Inc.

Matthew DeYoe
Analyst, Vertical Research Partners LLC

John Roberts
Analyst, UBS Securities LLC

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Tronox Limited Fourth Quarter 2017 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 a reminder, this conference call is being recorded.

I'll now turn the conference over to Brennen Arndt, Vice President, Investor Relations. You may begin.

Brennen Arndt
Vice President-Investor Relations, Tronox Ltd.

Thank you, Nicole, and welcome, everyone, to Tronox Limited's conference call to review our very strong fourth quarter results and discuss the extension to the Cristal acquisition agreement. On our call today are Jeff Quinn, President and Chief Executive Officer; and Tim Carlson, Chief Financial Officer. Joining us for the Q&A session will be Jean-François Turgeon, Chief Operating Officer, and John Romano, Chief Commercial Officer.

We will be using slides as we move through the conference call today. 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 slide 2, 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 but not limited to our Form 10-Q for the periods ended June 30, 2017 and September 30, 2017 and our Annual Report on Form 10-K for the year ended December 31, 2016.

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

It's my pleasure to turn the call over to Jeff Quinn. Jeff?

Jeff N. Quinn

President, Chief Executive Officer & Director, Tronox Ltd.

Thanks, Brennen, and thanks to each of you for joining us today. We are pleased to speak to you today from our offices in London to talk about our strong finish to a great 2017 and the developments with our transaction.

We are here having just concluded several weeks of discussions with our transaction partners at Cristal and its parent, Tasnee, that resulted in our announcement today that we've extended the end date of the acquisition agreement from May 21 to June 30, 2018.

In addition, the amendment provides us automatic three-month extensions until March 31, 2019, if necessary, based on the status of outstanding regulatory approvals. We pay no extension fee for this amendment. We also have the right to terminate their agreement if we determine regulatory approval of the transaction is not reasonably likely to be obtained. Of course, we do not believe that will be the case.

No fee is payable for a termination of the agreement prior to January 1, 2019. We, however, would be required to pay Cristal a $60 million dollar termination fee if regulatory approval has not been reached by March 31, 2019, and we or Cristal elect to terminate the agreement or if we elect to terminate the agreement after December 31, 2018, if we determine that regulatory approvals is not reasonably likely to be obtained.

This extension reflects the commitment of Tronox, Cristal and Tasnee to this transaction. We are working hand-in-hand to complete the transaction and get to the business of creating the premier company in the TiO_2 industry. Although we do not anticipate needing the full extension period to consummate the transaction, the amendment provides adequate time to optimize the outcome for the benefit of our collective stakeholders, our shareholders, our customers and our employees.

This extension agreement is the result of extensive discussion with our partners as to how best to move forward. We share a common goal to close this transaction as soon as possible. Each party brought its unique perspective and views to our discussion, which were accommodated and resulted in this amendment to the transaction agreement.

The amendment also made very minor changes to the shareholders' agreement with regard to Tasnee's board representation and the lockup provisions relating to their shares after closing. While the amendment to the transaction agreement provides us more time for the competition enhancing nature of this transaction to be determined on its merits, our goals remain to consummate this transaction as quickly as possible.

As you know, this is a highly synergistic transaction that will lower our cost position and increase supply. We will continue to work with regulatory authorities in the U.S. and Europe to find an appropriate and proportionate resolution to any valid concerns about the transaction. I'll provide an update on the overall transaction as part of my closing comments when I share our perspectives on 2018.

Now, I'll turn the call over to Tim Carlson for a review of our fourth quarter 2017 results. Tim?

Timothy C. Carlson

Senior Vice President, Chief Financial Officer & Director, Tronox Ltd.

Thank you, Jeff. Beginning on slide 4, the fourth quarter provided a very strong finish to a very successful year for us. We continue to build on the momentum generated in early quarters, momentum that we see continuing in 2018. Our TiO2 business delivered robust performance in the quarter, posting revenue growth of 32% and more than a fivefold increase in income from operations, adjusted EBITDA growth of 95% and an adjusted EBITDA margin of 34%.

Our full year was equally strong as revenues of $1.7 billion, increased 30% versus the prior year. TiO2's adjusted EBITDA of $500 million increased 112% for an adjusted EBITDA margin of 29%. TiO2 also delivered free cash flow of $345 million, up 33% from the prior year.

This high level of performance directly reflects the benefits of our vertical integration, as both our pigment and mineral sands operations delivered strong revenue and profit growth. Our results also reflect the extraordinary work by our global TiO2 team to reduce costs through the successful implementation of their Operational Excellence program. TiO2's performance for the full year was equally robust, posting adjusted EBITDA of $500 million and delivering free cash flow of $345 million.

Jean-François, many thanks to you and your team.

Here's an in-depth look at the drivers of the strong fourth quarter performance in TiO2, beginning with the top line and the year-on-year comparisons on slide 5. TiO2 segment revenue of $464 million increased 32% compared to the year-ago quarter, driven primarily by higher selling prices for pigment, zircon and pig iron. Pigment sales of $316 million, increased 28% as sales volume increased 2% and average selling prices increased 26% and that's 23% on a local currency basis.

Pigment selling prices were higher in all regions. Titanium feedstock and co-products sales of $133 million increased 45% compared to the year-ago quarter, driven by sales volume gains, the timing of shipments out of South Africa and higher selling prices. We realized higher selling prices for all three major co-products and significant volume growth for two.

Although zircon sales volumes were down 4%, lower than the year-ago quarter, a quarter in which we had the largest shipment volumes of zircon than any quarter in the last three years, zircon selling prices increased 38%.

Natural rutile sales growth was driven by 15% higher sales volumes and 10% higher selling prices. Pig iron sales volumes increased 87% and selling prices increased 32%. In feedstock, CP titanium slag sales volumes and selling prices were essentially level compared to the year-ago quarter. Ilmenite sales volumes increased 33%, while selling prices were 14% lower due to product mix, specifically the sale of lower-priced sulfate ilmenite rather than high-priced chloride ilmenite.

Moving to a sequential comparison, TiO2 segment revenues of $464 million increased 7%, driven by higher selling prices for pigment, zircon and natural rutile and the timing of shipments out of South Africa. Pigment sales of $316 million were essentially level to the seasonally strong third quarter. Sales volumes were 5% lower, reflecting the normally seasonally lighter fourth quarter, while selling prices increased 5% and also 5% on a local currency basis.

Selling prices were higher in all regions. Titanium feedstock and co-products sales of $133 million increased 23%, driven by higher selling prices and the phasing of shipments out of South Africa. Zircon sales volumes increased 10% and selling prices increased 16%. Natural rutile sales volumes increased 15% and selling prices increased 10%. Pig iron sales volumes increased 19%, while selling prices were 6% lower. In feedstocks, sales volume for CP titanium slag were level to the third quarter and selling prices increased 6%. Ilmenite sales volumes increased 37% while selling prices were 9% lower due to the product mix I referred to earlier.

Now, moving to profitability and cash flow metrics, TiO2 segment adjusted EBITDA of $156 million increased 95% compared to the prior-year quarter, reflecting a higher sales for pigment, zircon, natural rutile and pig iron, coupled with the benefit of higher production efficiency across our integrated operations.

In fact, the quarter was a bit stronger than we anticipated as we were successful in getting zircon, the slag fine and pigment iron shipments that generated revenue totaling approximately $20 million out of the sometimes unpredictable Richards Bay Port before the end of the year. The associated EBITDA was approximately $7 million to $8 million.

Our adjusted EBITDA margin increased to 34% in the fourth quarter. Compared sequentially, segment-adjusted EBITDA improved by 15%, driven primarily by top line gains, specifically higher sales volumes and selling prices for zircon and natural rutile and higher pigment selling prices. We normally do plant maintenance in the seasonally lightest fourth quarter and we did so again in this fourth quarter. Related incremental costs incurred in the quarter are capitalized in the inventory, which roll off into the P&L when the inventory is sold typically in the next quarter. The impact of maintenance costs incurred in the fourth quarter is expected to have an incremental $7 million to $8 million impact in the first quarter.

There is a headwind that will likely phase in 2018 and that is the strengthening South Africa rand. As a reminder, we priced the majority of our revenue from South African operations in U.S. dollars, while costs are incurred in rand. So, the strengthening of the rand reduces our South African margin structures. The rand has appreciated nearly 15% in the first two months of this year. Every ZAR 1 per dollar movement in the exchange rate impacts our quarterly results by approximately $7 million to $8 million. Jean-François and team continue to drive new operational excellence programs to offset the impact of the strengthening rand.

TiO2 delivered free cash flow of $68 million in the fourth quarter as cash provided by operating activities was $96 million and capital expenditures were $28 million.

So, in summary, another very strong quarter and one that directly reflects the benefits of our vertical integration with strong sales and profit growth in both pigment and mineral sands, which we expect will continue in 2018.

Moving to slide 6, I'd like to highlight a few points on our financial position. On December 31, 2017, gross consolidated debt was $3.15 billion and debt, net of cash and cash equivalents, was $1.38 billion, including $650 million of cash restricted for the Cristal transaction. Our net debt leverage ratio at the end of the year, on a trailing 12 months basis, was 3.3 times. Liquidity was $2.06 billion comprised of cash and cash equivalents of $1.77 billion, including the $650 million of restricted cash and $293 million available under revolving credit agreements.

Our blended cost of debt was 5.4% in the fourth quarter. And on December 31, 2017, 33% of our total indebtedness was set at a fixed rate. Our goal is to move this closer to a 50/50 ratio, given our planned debt repayments.

For the full year 2018, we forecast our cash interest to be approximately $170 million. Given the current interest rate environment, we expect to launch a process to refinance our $584 million of 7.5% 2022 bonds after the March 15 call date. Capital expenditures for the year were $91 million and depreciation, depletion and amortization expense for the year was $182 million. We expect capital spending in 2018 of $120 million to $130 million and DD&A of $180 million to $200 million, both on a standalone basis.

Given the tax law changes, we thought it'd be timely to review our tax position with you. As you know, Tronox has very favorable tax attributes both in the United States and abroad. They're outlined for you on slide 7. Recently enacted tax legislation will have a minimal impact on Tronox. We do not have any foreign operations, no CFCs or controlled foreign corporations. So, there are no global intangible low-taxed income or, as the government has named, GILTI Tax implications.

Given our current structures and activities, there will also be no BEAT implications or Base Erosion Anti-Abuse Tax implications. Our deferred tax assets have 100% valuation allowance, given the historical losses. The change in U.S. corporate tax rate from 35% to 21% significantly reduced both our deferred tax assets and our valuation allowances. There was a $1 million favorable net impact on our financial results, given a small deferred tax liability.

Interest expense deductions are now limited to 30% of EBITDA for the next four years and then 30% of EBIT, but can now be carried forward indefinitely. Previously, deductions were allowed at 50% of EBITDA. Our expected cash tax in 2018 is approximately $20 million on a Tronox standalone basis.

With that, I thank you and I'll now turn the call back over to Jeff.

Jeff N. Quinn

President, Chief Executive Officer & Director, Tronox Ltd.

Thanks, Tim. We're confident that 2018 will be another year of strong performance for our company. We see the momentum in our TiO2 business continuing well into 2018 and we expect to benefit from favorable market conditions in both pigment and titanium feedstock and co-products and from our vertical integration with all of our assets in full operation.

We see continued tightness in the global supply/demand balance 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 are running at high utilization rates compared to historic levels, because of these favorable market conditions, including the Chinese producers. 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 the cycle.

We are redoubling our efforts to ensure that we are a reliable supplier to the market, deliver the maximum level of production at a fair price that reflects the value created in order to assist our customers as they grow in their markets.

Because of these tight pigment market conditions, we are seeing tightened conditions in feedstock markets as well. As a fully integrated producer, we benefit from rising margins at both feedstock and pigment levels. We are also seeing continued tightening supply/demand conditions in zircon. 2018 will undoubtedly be a year of transformation for Tronox.

Regarding the Cristal acquisition, as I've stated earlier, we continue to work with the regulatory authorities in both the EU and the U.S. to reach appropriate and proportionate resolutions to any valid concerns they have about the transaction. In Europe, we expect the European Commission to decide in the coming weeks whether to file a statement of objections in which it will inform us more formally if it has any continuing concerns about the transaction.

Subject to our reply to both possible objections, it is at that time that we can commence meaningful discussions to find an appropriate and proportionate resolution for any such possible concerns. Our goal is to resolve any issues with the EC as quickly as reasonably possible.

Just a comment on the EC suspension of the review that was announced last week. For any of you that have experience in this area, you realize that these stop-the-clock situations do arise in Phase 2 investigations for various reasons from time to time. In this instance, it was due to our process issue around documents that the EC demanded, in particular documents for which we asserted attorney-client privilege and which required the company to make sure it was fully protected before producing these documents. There was no error in our filing or missed documents as some investors presuppose and the clock was restarted on February 28.

In the U.S., we continue to pursue parallel paths towards resolution. Given that the EC review is still underway, the pursuit of these parallel paths has not slowed down the completion of the transaction, given the FTC's decision in December to challenge the deal. In fact, any paths that we have pursued has been for the purpose of trying to expedite the matter.

We continue to defend the transaction in the FTC's Part 3 administrative proceedings. The Part 3 proceeding is currently in the discovery stage. Depositions are underway and will soon proceed to expert discovery. The Part 3 trial is currently scheduled to begin on May 18.

We believe we are well positioned to make a vigorous and successful defense in the Part 3 hearing. At the same time, Tronox's litigation against the FTC in the Northern District of Mississippi remains pending. As you may know, the Federal Government gets more time compared to other litigants to file a responsive pleading. And as such, the FTC's answer is not due until late March. While we were disappointed that the court in Mississippi declined to expedite the matter, we remain confident in the substance of our position in the Mississippi litigation that the Part 3 process should not be used to run out the clock and to circumvent a determination on the merits.

Our view on that is not unique or novel. In fact, in recent days, current nominees for the Commission have addressed this point. On February 14, it was widely reported that at his initial confirmation hearing, President Trump's nominee to head the FTC stated, in terms of where the FTC files its merger challenge, I think it should be in the federal court. Also a nominee for another seat on the Commission was quoted as saying, I would think, as a general matter, for unconsummated mergers, seeking a preliminary injunction in federal court would be my inclination. The nominee went on to say that as a general rule, seeking a preliminary injunction in federal court would be the right way to go.

In addition, in response to questions for the record submitted from Senator Wicker of Mississippi, the nominee to head the Commission responded, while there are benefits to the Commission's administrative litigation path, it should be used on the merits and not to disadvantage any party such as running out the clock. Finally, in response to a further QFR from Senator Inhofe of Oklahoma, the nominee made several references to the fact that mergers should be judged on the merits and the administrative process should not be used to simply run out the clock.

While the synergies of the acquisition in the U.S. are considerably less than those outside of the U.S., there is significant value to be derived from the ownership and operation of the U.S. assets, value that we intend to continue to pursue. There are multiple scenarios for resolution in the U.S. with varying degrees of incremental value creation depending on the quantum of the U.S. assets that may eventually be acquired. I'm sure many of our investors have modeled these scenarios extensively. We have two and believe there is a 15% to 20% additional upside to value creation by pursuing the U.S. business in full compared to not acquiring any of the U.S. business.

In addition to a desktop valuation of the presumed accretion to our equity value at a particular point in time, I believe it's important to keep in mind the longer-term aspects of our pursuit. Clearly, for the long term, by owning these assets, we are a stronger, better positioned and more competitive pigment producer across the cycle in what is 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 enhance our competitiveness globally.

We have our focus clearly on the significant value drivers of this transaction. We have our eye on the ball. We are not driven by a competitive desire to win at all cost. We are focused on creating value for our shareholders and serving our customers. We intend to close this transaction at the earliest possible time.

In addition to continuing our work with the regulators to convince them of the merits of the transaction, which we believe to be pro-competitive, we are nonetheless willing to address and find an appropriate and proportionate resolution to any valid concerns that the regulators may have in Europe or in the U.S. and to work constructively and efficiently with the agencies in this regard.

Now, just a comment on our balance sheet as it relates to the transaction. Rapid de-leveraging of our balance sheet is preserved in all scenarios. Our intention to achieve a net debt to trailing 12-month EBITDA ratio of less than 3x by 2019 is unchanged. Thereafter, we intend to operate our business in the 2x to 3x range across the cycle.

Both Tronox and Cristal continue to perform well. Our estimate of the 2018 pro forma EBITDA is unchanged at between $950 million and $1 billion and that is without synergies. Tasnee released their fourth quarter report earlier this week and commented on Cristal's performance. We encourage you to take a look at that report.

As you have heard us say consistently since the day we announced the transaction, this highly synergistic combination is all about increasing asset utilization, lowering our cost position and unlocking incremental product volumes to serve growing markets worldwide. We are ready to demonstrate the pro-competitive merits of this transaction and how this output-enhancing combination would generate significant benefits for customers in North America and around the world.

Separately, from the acquisition agreement, we have substantially completed negotiation of a technical services agreement with Cristal and Tasnee to assist them in bringing on stream their titanium slagger in Jazan, Saudi Arabia. The slagger is an economically attractive potential additional source of feedstock for the 11 pigment plants that the combined company would have. We continue to negotiate an option to purchase the titanium slagger.

In addition to completing the acquisition, we also anticipate changes to our debt and equity structure this year, both similar to the changes that occurred last year. As Tim mentioned, we expect to launch a process to refinance our 2022 bonds after the March 15 call date. And on the equity side, Exxaro has announced their intention to monetize a portion or all of their holdings sometime this year. Last October, Exxaro sold 22.4 million shares in an underwritten registered offering, reducing their ownership from approximately 44% to approximately 24%. They have not announced the timing of any potential offering, but we do expect that to occur in 2018.

As you know, we have significant operations in South Africa. Recent changes to the political leadership of South Africa should create stability and benefit our operations in the country over the long term. The previous administration had proposed a radical new Mining Charter early last year, which met with significant pushback from the mining companies operating in South Africa. The industry's representative organization, the Chamber of Mines, began legal action to oppose the new charter.

Following the Presidential change last month, the Chamber agreed to postpone its court application on the basis of the President's commitment to resolve the impasse by facilitating the development of a new Mining Charter by way of negotiation. The government intends that the negotiations will be inclusive of all stakeholders, including government, business, labor and communities in the interest of the industry and the country as a whole.

In addition, the new President has appointed a new minister of the Department of Mineral Resources, who yesterday announced a goal of finalizing the new Mining Charter within three months. We are optimistic that these changes will usher in a new era of cooperation and progress between the industry and the government. We are committed to being a constructive participant in that process.

Finally, before we open it up for your questions, I would like to take just a moment to address our priorities for the year. First, we must continue to produce safe, quality low-cost tons. This is a mantra that my friend, Jean-François, has made ever-present in our company over the last few years, but that's never more important than at a time like this.

We are in a very good market environment. We must take advantage of that market by operating reliably, manage our planned maintenance to maximize output, produce on spec, drive operational excellence and, most importantly, manage our safety performance. JF and his team do that very well, but we must continue to do so.

Second, we must deliver on the promise of the Cristal acquisition. The first step in that, obviously, is getting the deal to close. We remain very focused on that. Then, we must integrate it and deliver on the synergies. We are focused on that and we'll have a strong process in place to track and report our progress in that regard.

Third, during the year, I will personally focus on making an already world-class organization even better. We are upping the bar. We will focus on developing our people, enhancing our talent and improving our organizational efficiency.

Fourth, this year, I will work with Tim to refine and communicate a clear capital allocation strategy to guide us for 2018 and beyond. That balances debt paydown, capital expenditures to drive our business forward, return of capital to the shareholders and growth.

Finally, we will begin to define the future for Tronox. While the next 18 to 24 months will be about integration, execution and delivery of synergies, we must manage the present with our eyes for the future. We'll be working with our board as the year progresses to do exactly that.

With that, I thank you. And now, we would like to open it up for your questions. Nicole?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Frank Mitsch of Wells Fargo. Your line is now open.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC
Q

Hey. Good morning/good afternoon.

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

Good morning.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC
Q

Jeff, nice quarter and obviously a nice extension of the Cristal transaction. I was just thinking it's been 53 weeks since you guys announced that transaction. I was wondering where the European Union was for much of that time period, but now looks that they're actively involved. And I was just curious you've previously stated with respect to synergies that Ashtabula is not a key driver for your synergy capture. How would the Stallingborough facility for Cristal rate in terms of expectations of driving synergies?

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

Yeah. Thanks, Frank. And you've correctly stated what we've said in the past that in terms of deal synergies per se that a lot of those are not related to the Ashtabula plants. With respect to Stallingborough, there is more of the synergies. A overwhelming portion of the synergies are ex-U.S. and there is a portion of those that do relate to the Stallingborough facility.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC
Q

All right. And I'm not going to ask a follow-up exactly where the EU is coming at you from, but just turning to business conditions right now, we're two months into Q1, there have been some unplanned outages on the feedstock side of things, both in Africa and in Europe. How is your business trending on the feedstock side of things and can that be a nice material step-up as we start 2018?

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

Hey, Frank, this is John. As far as our feedstock business, as you know, most of what we do is internal, because we're vertically integrated, but we're seeing the feedstock – as Jeff mentioned on the call, we're seeing that business start to pick up as well with regards to price. It typically trails and lags behind the TiO_2 industry and it's falling in line with what we expected. And we don't have a significant volume footprint, though, on the external market, because we consume the majority of what we produce.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

But you are seeing feedstock pricing move up in response to that, which then would make your competitors need to raise their pigment prices to offset that inflation, correct?

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

A

Yeah. We are seeing prices move up on feedstock. That's correct.

Frank J. Mitsch
Analyst, Wells Fargo Securities LLC

Q

Terrific. Thank you.

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

A

Thanks, Frank.

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

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Good morning, Jeff.

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

A

Hi, Hassan.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Jeff, you've talked the synergy side of things on the various scenarios, deal, remedy and the like, but clearly, you guys must have had extensive discussions with Cristal/Tasnee over the last couple of weeks. Broadly speaking, could you sort of give us some sort of a thought-process with regards to deal price? I mean, obviously, multiple scenarios with remedies baked in, no remedies baked in and the like and overlaying on that the fact that Cristal/Tasnee will become a large shareholder of yours going forward as well.

So, even if the deal price does not change, they would indirectly benefit from your share price doing well. So, just would love to hear your thoughts about how these discussions are going with regards to the deal price with Cristal under these various remedies scenario.

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

A

Yeah. Thanks, Hassan. And absolutely, we share a common goal with our partners at Tasnee and Cristal to complete the transaction at the earliest possible time. We're now sometime down the road from when the original economics of the transaction were established. And, obviously, a much longer time than any of us imagined in terms of the time period between that and consummation. The economics of the transaction remain the same. They're unchanged by this amendment.

You're exactly right, Tasnee or the current shareholders at Cristal will become major shareholders of Tronox upon conclusion of the transaction and will benefit from the increasing and improving market conditions that we currently have. So, we believe that it was a fair and reasonable price agreed to a year plus ago. And we believe that the transaction is still fair and appropriate for all the parties and, as I said, remains unchanged.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Perfect. And as a follow-up on the fundamental side of things, Frank asked earlier about the feedstock side and clearly some outages there and some sort of supply/demand tightness even beyond the outages evolving. But on the pigment side of things, some puts and takes, it seems some incremental capacity has been announced in China, but alongside that, obviously, there are environmental-related capacity closures as well. So, how are you seeing things in terms of global supply, 2018, 2019, 2020 time period? I mean, do you think that, on a net-net basis, supply would be flat to down or would supply actually be right?

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

A

I'll let John Romano address that.

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

A

Yeah. I think you're referring to Lomon Billions' announcement on one of your comments and the expansion...

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

That's correct.

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

A

...in China. And I think what's been consistent is they've been speaking about growth profile on that particular asset for quite some time. And I think their announcement was pretty much just a follow-through on what they had been talking about for the last several quarters.

So, from China's perspective, we're continuing to see its environmental issues which are limiting some of the assets that we would have thought come back online – coming back online. So, even though this additional capacity that they've announced of 200,000 tons in 2019, in our opinion, I would say is a bit aggressive on timeline. It wasn't unexpected.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Understood. And so, just from a supply perspective, do you still continue to see [indiscernible] (40:38) the supply environment over the next couple of years – supply growth environment?

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

A

Yes. So, with regards to just the overall supply and demand, I think right now, we're in balance. Inventories, as Jeff mentioned, are at or below seasonal norms. And considering what's been announced and the environment that we're operating in right now, we don't see that turning in 2019. We continue to see a stable supply/demand situation, which would have a positive impact on our business.

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

A

Yeah. I think we see now the incremental expansion over the next 18 to 24 months will really kind of just be soaked up by the incremental global growth. So, we don't see that, that incremental expansion will significantly change the current dynamics.

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

A

At 6.2 million tons of current demand, 200,000 tons is about 3% growth and that's what you need to support it.

Hassan I. Ahmed
Analyst, Alembic Global Advisors LLC

Q

Fair enough. Fair enough. Very helpful, guys. Thanks so much.

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

Michael J. Leithead
Analyst, Barclays Capital, Inc.

Q

Hey, guys. It's actually Mike Leithead on for Duffy this morning. I guess first...

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

A

Hi, Mike.

Michael J. Leithead
Analyst, Barclays Capital, Inc.

Q

Hi. First on the deal extension, I guess all of the verbiage today talked about in the event regulatory approval seems unlikely, but can you just clarify on what happens if the parties either, A, decide to break the deal for non-regulatory reasons or, B, you could get regulatory approval, but the divestitures would be too onerous? Would there be break fees in either of those scenarios?

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

A

Well, I think that the very, very limited circumstances for the parties -situations for the parties to break the deal, absent a failure of a condition, including the regulatory approvals to be satisfied. So, we don't see that as a significant issue at all. I think with respect to the whether the regulatory approvals may be too onerous, I think there is a standard in the agreement that if regulatory requirements would be detrimental to Tronox, that it would give us a right to terminate the agreement if we saw fit. But based upon our current knowledge of the regulatory situation, we do not believe that any reasonable and appropriate remedy would at this time be viewed as resulting in a detriment that would give us reason to want to terminate the transaction.

Michael J. Leithead
Analyst, Barclays Capital, Inc.
Q

Got it. Okay. And then, I think you mentioned the potential for Exxaro to come to market this year in offering. Is that dependent on the status of the Cristal acquisition approval and, what I mean by that is, are they precluded from going to market while these negotiations are ongoing? Thanks.

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

No. I think that there's no legal preclusion from them coming to market with their shares at a given time as long as there's no material non-public information and we don't believe that there is with the status of the transaction. I think the exact timing and whether that timing is impacted by the status of the Cristal transaction is something that Exxaro would have to address.

Michael J. Leithead
Analyst, Barclays Capital, Inc.
Q

Got it. Thank you.

Operator: Thank you. Our next question comes from the line of Matthew DeYoe of Vertical Research. Your line is now open.

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

Hi. So, I believe you'd been on track to restructure your operations, so that all the company earnings outside of some mineral sands ops in South Africa would be treated as U.S. income for tax purposes. Is this exercise still feasible, given the change in U.S. tax laws, and can you kind of update us on where you are in the process?

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

Yes. It is still feasible. Obviously, there is some additional analysis that we've got to do as a result of the activities, but we're still relatively comfortable that given the structure of the transaction that we should be able to get 50% to 60% of the income into the U.S. on a long-term basis in order to leverage our tax attributes.

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

Okay. And then, can you talk a little bit about the utilization rates in the mineral sands industry and the implications of Iluka's Cataby mine finally getting green light?

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

As far as – I mean, on the feedstock, if you want to break that down into high-grade feedstock with Iluka, I mean they've been talking about the Cataby mine for quite some time and now they're moving forward with it. So, obviously, that will probably help them produce more SR and entice them to start another kiln up, but at this particular stage, there is, as was mentioned earlier on the call, had been some other disruptions in high-grade feedstock supply. We're running our assets at full capacity and I would expect that the majority of our competitors are doing the same thing.

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

How about on the ilmenite side of the equation?

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

I think the same...

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

Yeah. I know it's unrelated to Cataby, but okay, all right, so fairly sold out at this point?

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

Yes.

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

Thank you.

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

And maybe, John, if I may add, the Cataby mine is really a mine that allow Iluka to maintain their operation, because as their older mine are depleting, they needed to invest in Cataby in order to maintain their production.

Matthew DeYoe
Analyst, Vertical Research Partners LLC
Q

Thank you.

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

John Roberts
Analyst, UBS Securities LLC
Q

Thank you. Nice quarter.

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

Thanks, John.

John Roberts
Analyst, UBS Securities LLC

Q

Are you selling your excess ore production at higher prices than Cristal is buying ore? I'm just trying to figure out what happens when that volume moves from being sold outside in the market to the internal economics when Cristal starts using it?

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

A

Hey, John. Those of us on the phone are not on the Clean Team and we don't have access to the information about what Cristal is buying their ore for. Those walls have been erected and are maintained diligently. So, we really can't comment on that.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. And then, on slide 8, where you comment on working proactively with customers to stabilize volatility, are you specifically referring there to the potential for multiyear fixed-price contracts and maybe could you give us an update on what you're thinking there?

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

A

Yeah. Look, we're not really prepared to go into details around the contracts that we're working on, but clearly the objective is to try to figure out how we can stabilize our margin over a longer period of time, so that we can reinvest in the business throughout the cycle. And I'd say we're at various levels of negotiation globally with customers on ways to implement that.

John Roberts
Analyst, UBS Securities LLC

Q

Okay. Thank you.

Operator: Thank you. Our next question is from the line of Roger Spitz of Bank of America. Your line is now open.

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Thank you very much. Good afternoon. I take it regarding the lenders that you have approval from the lenders to extend the loans situation out to the new March 31, 2019 termination date.

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

A

There was a term within the agreement that was an automatic extension if the underlying Cristal agreement was extended.

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

It just files it. Got it.

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

You're referring to the $650 million of restricted cash, correct?

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.
Q

Yeah.

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

Yeah. That automatically extends with...

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.
Q

It just files it. Got it. Can you comment if you're contemplating refi-ing the 7.5s with new senior unsecured notes or do you envision alternative refinancing options?

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

Yeah. We're looking at alternatives right now with our advisors. We haven't yet made that decision, but we expect to do so within the next week. I guess, just given the uncertainty right now in the interest rate environment and given where our mix of debt is, I would say we're probably leaning more towards bond and term.

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.
Q

Great. And you said there was a mix shift to sulfate ilmenite from the higher-priced chloride ilmenite. Can you discuss some market dynamics that necessitated the shift in your product mix?

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

Look, not really. I think, the end of the day, I think what Tim was referring to was that we sold some ilmenite this past quarter that went to a different segment. So, historically, we don't sell a tremendous amount of high grade feeds or high grade ilmenite into the chloride segment. This particular quarter, we sold some that went into the sulfate market. So...

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

It was inventory we had available that we want to monetize into cash.

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.
Q

Got it. Okay. So – okay. I think I understand. And lastly for me, in zircon, can you update us on what the Chinese are doing with their tile manufacturers? Is the environmental issues closing some tile operations and that is potentially reducing your volumes into that market?

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

A

Look, at this particular stage, we're seeing the market in China to be somewhat robust. So, there's not been a tremendous amount of change in how much zircon is actually in the tiles. We're seeing demand for zircon, as we referenced earlier, being robust and which has had a positive impact on our pricing. And considering where inventories are at this particular stage, we don't see anything in the near future changing that.

Roger N. Spitz
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Thank you very much.

Operator: Thank you. Our next question comes from the line of Jeff Zekauskas of JPMorgan. Your line is now open.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. In the light of the changes in the U.S. tax code, did your assessment of the present value of your tax benefits change? And if it did, by how much did it change?

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

A

Okay. You'll see in our footnote that the value of our deferred tax asset came down. I think it close to $300 million or $400 million as a result of the change in rates, but obviously, given that we've got a full valuation allowance, there is no impact on us from a financial statement perspective.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Okay. When you look at the chloride-based Chinese capacity and production in 2017, did it change very much in on your opinion?

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

A

There was very little change in production with regards to what was added and then what was closed down. I think from a capacity perspective, earlier in 2017, there was a bit more capacity down than there was today. Where our expectations are that overall capacity utilization in China right now is about mid-70 percentage, obviously something higher and something lower, but I would say again, as I mentioned earlier, some of those closures that we thought would have been on backup and running by now was a bit surprising that they're still offline.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

It looks like you're going to spend $30 million to $40 million more in CapEx in 2018 than in 2017. What are you spending that on?

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

A

It's just primarily just phasing some of our operations. Some of our capital in Q4 got phased into Q1. Our Q4 capital is about $10 million to $15 million lower than what we anticipated. So, it's just pure phasing capitalization of activities.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Where does that go or what are the projects you're working on?

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

A

Yes. We've got initiatives in South Africa and in Hamilton are the two big ones.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you so much.

Operator: Thank you. [Operator Instructions] I'm showing no further questions at this time. I'd like to hand the call back over to Jeff for any closing remarks.

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

Thanks, Nicole. We thank each of you for joining us today. We look forward to 2018. As I said, we're in the midst of a year of transformation for Tronox. We continue to be focused on bringing our transaction with Cristal to a successful conclusion and we're confident that that will occur this year. We look forward to getting about the business of delivering to you, our shareholders, the value created by that transaction. And we will continue to focus on running our business safely and efficiently in order to realize that promise.

So, thank you very much. And we look forward to talking to you in the weeks to come about our good results and the progress we're making on the transaction.

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