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Tronox Holdings Plc (TROX)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Jennifer Guenther

Vice President-Investor Relations, Tronox Holdings Plc

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Timothy Craig Carlson

Chief Financial Officer & Senior Vice President, Tronox Holdings Plc

OTHER PARTICIPANTS

Aziza Gazieva

Analyst, Fermium Research LLC

John P. McNulty

Analyst, BMO Capital Markets Corp.

Duffy Fischer

Analyst, Barclays Capital, Inc.

David Begleiter

Analyst, Deutsche Bank Securities, Inc.

Joshua Spector

Analyst, UBS Securities LLC

Matthew DeYoe

Analyst, BofA Securities, Inc.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Tronox Holdings Q3 2021 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please also note, today's event is being recorded.

And at this time, I'd like to turn the conference call over to Jennifer Guenther, Vice President of Investor Relations. Ma'am, please go ahead.

Jennifer Guenther

Vice President-Investor Relations, Tronox Holdings Plc

Thank you, and welcome to our third quarter 2021 conference call and webcast. On our call today are John Romano and Jean-François Turgeon, Co-Chief Executive Officers; and Tim Carlson, Chief Financial Officer.

We will 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 investor.tronox.com.

Moving to slide 3. A friendly reminder that comments made on this call and the information provided in our presentation and on our website include certain statements that are forward-looking and subject to various risks and uncertainties, including, but not limited to, the specific factors summarized in our SEC filing. 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-US GAAP financial terms that we use in the management of our business and believe are useful to investors in evaluating the company's performance. Reconciliations to their nearest US GAAP terms are provided in our earnings release and in the Appendix of the accompanying presentation.

Moving to slide 4, it's now my pleasure to turn the call over to John Romano. John?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thanks, Jennifer, and good morning, everyone, and thank you for joining us today. I'd like to set the stage this morning by providing you with a quick overview of Tronox. We're the world's largest vertically integrated TiO₂ producer with nine pigment plants, six mines, and five upgrading facilities on six continents.

Our trailing 12-month totaled – our trailing 12-month revenue totaled approximately \$3.5 billion, which is fairly evenly distributed across the Americas, Europe, Middle East and Africa, and Asia Pacific. Our 1.1 million tons of pigment capacity supports our well-balanced base of more than 1,200 global customers. Our vertically integrated business model supplies approximately 85% of our internal feedstock needs, and this ensures consistent and secure supply for our customers.

In addition to TiO₂, we generate significant value as the world's second largest producer of zircon, with approximately 297,000 tons of production capacity. We are very proud of the organization we've created following the transformative acquisition two years ago and the value we have and will continue to generate for our stakeholders.

Turning to slide 5, we've maintained our strong execution this quarter expanding margins, as the improved pricing and cost savings have offset increased commodity and freight costs. We generated another record quarter of free cash flow from our differentiated business model, allowing for a deleveraging ahead of our targeted objectives.

The third quarter saw a continuation of higher volumes in average selling prices for both TiO₂ and zircon compared to the prior year, owing to sustained recovery across our markets, along with a strong demand for our products. Additionally, our capital projects remain on track with the newTRON implementation progressing on schedule to provide the digital transformation that will enable a meaningful long-term cost reduction.

Turning to slide 6, we are very pleased with our third quarter results, and they were in line with our previously issued guidance. Revenue in the third quarter increased 29% year-over-year, driven by higher average selling prices and volumes. Sequentially, this represented a 6% decline as higher average selling prices were offset by lower volumes as we anticipated and flagged last quarter. This was due to isolated chlorine availability issues, which impacted production early in the quarter, but have since been resolved and logistics challenges that persisted throughout the quarter.

Net income for the quarter was \$113 million and diluted earnings per share was \$.70, while adjusted earnings per share was \$0.72. The difference between diluted EPS and adjusted EPS is due primarily to debt redemption costs.

The company delivered third quarter adjusted EBITDA of \$252 million, another record for Tronox, and a year-over-year improvement of \$104 million. This figure came in, in the middle of our guided range due to higher average selling prices across all products, increased zircon and TiO₂ volumes, and improved absorption at our mining and pigment sites, partially offset by unfavorable exchange rates, increased freight costs, and higher process chemical and energy costs compared to the prior year quarter.

Our adjusted EBITDA margin was 29%, a 700 basis point improvement year-over-year due to increased pricing, favorable product mix, and our ability to deliver on our cost improvement initiatives. We generated record free cash flow of \$191 million in the third quarter owing to our differentiated business model, focused on vertical integration, enabling favorable fixed cost absorption and lower feedstock costs relative to the market and ongoing benefit of having zircon as a co-product in our portfolio. We continue deleveraging in the quarter reducing total debt to \$2.7 billion and net leverage ratio to 2.6 times within our long-term targeted range of 2 to 3 times, well ahead of our stated 2023 timeframe.

Moving to slide 7, I'll now review our commercial performance in more detail. As previously highlighted, the third quarter saw strong pricing trends driven by the continuation of our regional pricing initiatives. TiO₂ saw the strongest third quarter volume on record due to high demand as it continues to outstrip supply and inventories that remain below normal levels throughout the supply chain. TiO₂ revenue was \$682 million, an increase of 26% year-over-year, driven by a 13% increase in volumes and a 12% increase in average selling prices on both the local and US currency basis. Volume growth was led by double-digit growth in Europe, Middle East and Africa, and Asia Pacific compared to the prior year. Compared to the second quarter, TiO₂ revenues declined 8%. This was driven by a 4% increase in TiO₂ prices on a local currency basis, offset by volumes declining 10% at the bottom end of our guided range.

Zircon also saw the strongest third quarter volumes on record. Volumes were up 81% year-over-year on sustained strong demand, and average selling prices increased 13%, leading to an increase in revenue of 107%. As anticipated, Zircon volumes declined sequentially due to higher sales from inventory in the second quarter. Feedstock and other products declined year-over-year due to no external feedstock sales in the quarter compared to the prior year, partially offset by increased pig iron revenue and higher average selling prices. Our quarter-over-quarter basis revenue increased driven by higher pig iron pricing.

JF and I are once again very proud of the way our team navigated through numerous external challenges this quarter to deliver financial results in line with our third quarter guidance. We're working tirelessly with our dedicated team of employees to ensure we are the supplier of choice for our customers by leveraging our unmatched global footprint and vertically integrated business model. Given inventory levels remain below normal, coupled with the strategic initiatives we have in place, we believe we're well-positioned to continue to meet growing customer demand.

In the fourth quarter, demand is expected to outpace supply. We're anticipating fourth quarter TiO₂ volume levels to be flat to down mid-single digits due to continued supply chain disruptions. Pricing is expected to continue to increase consistent with the quarterly movement we've seen in 2021. Zircon sales volumes are expected to remain elevated above 2019 and 2020 levels. However, volumes in the fourth quarter will be lower than those in the third quarter, more in line with production levels. Zircon pricing improvement in the fourth quarter is expected to more than offset volume headwinds on an EBITDA basis and we now expect this trend to continue for the full year 2022.

I'll now turn the call over to JF for a review of our operating performance and profitability in the quarter. JF?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thank you, John. Moving to slide 8, as John mentioned, adjusted EBITDA of \$252 million was another record for Tronox. The increased volume and pricing supported significant increase in EBITDA year-over-year, which were partially offset by unfavorable FX rate and higher freight rate. With production costs in the prior year comparison, commodity cost increase were offset by improved absorption and cost reduction initiative. On a sequential basis, increased price across all products and favorable FX rate drove improved EBITDA, partially offset by higher freight rate and increased production costs. Within production costs in the sequential comparison, cost improvement from favorable absorption due to a resumption of normal production at our synthetic rutile facility and at our Botlek pigment plant, were offset by increased commodity costs.

Inflationary pressure, including both external ore purchase and commodity price such as energy and sulfur as well as increased logistic costs continue to impact our earnings, but have largely been offset by cost improvement initiative. Higher freight and commodity costs trend will continue in the fourth quarter above the level we previously anticipated. However, our mining and upgrading facility continue to run at high operating rate at a time when feedstock are critical. This, combined with our integrated planning capability, will allow us to increase production in Q4 and produce an additional 40,000 ton next year.

Turning to slide 9, I'd like to provide an update on our key capital projects. We continue to progress project newTRON, our enterprise-wide cost reduction initiative that will transform our business, enabling us to remain among the lowest cost TiO₂ producer and enhance service to our customer. We will achieve this through an optimized global supply chain, reduced maintenance spend, enhanced automation and throughput, and standardized process. We expect newTRON to unlock cost reduction of \$150 to \$200 per ton by the end of 2023. The capital outlay for project newTRON remain \$150 million combined across 2021 and 2022. Approximately, \$65 million will be invested this year with the balance expected to be invested in 2022.

Our business model is our source of differentiation, and Atlas Campaspe represents the next phase of investing in our vertically integrated portfolio. This mining project will replace the existing Snapper/Ginkgo mine in Eastern Australia and is expected to come online in the second half of 2022. These [ph] elements (00:13:11) are abundant in natural rutile, high-value zircon and high-grade ilmenite suitable for synthetic rutile production, slag processing, or direct pigment production. Estimated capital expenditure are \$70 million in 2021 and \$80 million in 2022. This investment will sustain Tronox 85% internalization of feedstock, supporting approximately \$300 per ton saving relative to average high-grade feedstock market price.

We also want to update you on the slagging operation in Jazan. We have completed the technical modification and cold commissioning, and hot commissioning is currently in progress. We anticipate the first slag production late this quarter. However, as a reminder, slag production must reach sustainable operation before Tronox will assume ownership of the site. Based on the current plan, the earliest the site could achieve sustainable operation would be fourth quarter of 2022. At Tronox, we are on a journey of transformation, and these key projects will allow us to deliver on our commitment to our stakeholders. We will continue to keep the market updated on the progress of these projects.

I will now turn the call over to Tim Carlson. Tim?

Timothy Craig Carlson

Chief Financial Officer & Senior Vice President, Tronox Holdings Plc

Thank you, JF. On slide 10, I'll review our financial position, liquidity, and capital resources at the end of the quarter. This quarter, we achieved net leverage target of 2 to 3 times two years early, and in the third quarter with 2.6 times net leverage on a trailing 12-month basis, down from 4.1 times at the end of 2020. Total debt was \$2.7 billion, a significant reduction from the \$3.3 billion balance at the end of 2020. We are well on our way to reach our \$2.5 billion gross debt target, which we expect to achieve no later than Q1 2022. Total available liquidity as of September 30 was \$764 million, including \$309 million in cash and cash equivalents and \$455 million available under revolving credit agreements.

Moving to the right-hand side of the page, capital expenditures in the third quarter were \$65 million, totaling \$183 million on a year-to-date basis. We're currently anticipating \$120 million of capital expenditures in Q4, reflecting the pacing of expenditures related to the newTRON and Atlas Campaspe capital projects and other maintenance spend. Our total year outlook is now approximately \$300 million. Depreciation, depletion and amortization expense was \$72 million in the quarter. Our free cash flow in the quarter was \$191 million, totaling \$418 million year-to-date due to our strong cash earnings. Year-to-date, we also returned \$46 million to shareowners in the form of dividends.

Turning to slide 11, I'd like to share our outlook. As John mentioned, both TiO₂ and zircon prices are expected to continue to increase, as we make progress with our regional pricing initiatives. The TiO₂ market demand remains very strong, though we are balancing our market outlook with the ongoing global supply chain and logistics constraints. We expect fourth quarter TiO₂ volumes to be flat to down mid-single digits.

Zircon sales volumes are expected to remain elevated above 2019 and 2020 quarterly volume levels, [ph] though (00:17:18) lower than Q3 levels. We expect our Q4 2021 adjusted EBITDA to be \$230 million to \$245 million due to logistics challenges, higher freight and commodity costs and some less favorable product mix. FX rates have come off their recent lows and are expected to remain relatively neutral net-net on a sequential basis.

Moving to our expectations for full year 2021, we anticipate the following uses of cash: net cash interest expense of \$130 million to \$140 million; \$40 million to \$50 million of cash taxes; capital expenditures of approximately \$300 million, which includes expenditures related to newTRON and Atlas Campaspe; and pension contributions of less than \$5 million. We expect working capital to be a modest source of cash for the year. These represent our best estimates based upon our current market outlook.

With regard to capital allocation, with our \$2.5 billion gross debt target in sight, we expect to prioritize capital expenditures, continued annual dividend increases, and shareholder repurchases – share repurchases.

I'll now turn the call back over to JF for closing remarks before opening the call up for questions. JF?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thank you, Tim. We want to close the call by spending a few minutes on our strategy, sustainability effort, and key takeaway as we head into the final month of the year. First, on slide 12, I want to revisit our strategy to become an advantage global TiO₂ leader, which is built on five pillars: the people, the vertical integration, the technology, the global footprint, and our competitive costs.

Our effort and capital expenditure will be dedicated to pursue these pillars through project like newTRON and Atlas Campaspe. As I outlined, newTRON will transform our operation through automation and digitalization, both of which are fundamental in reducing our costs and enabling Tronox to be a technology leader. Atlas Campaspe will reinforce our distinct advantage through feedstock integration. Our strategy drives our ability to leverage our

unique portfolio, to optimize our asset, and secure our position as the most adaptable, resilient TiO2 industry leader, allowing us to continue to deliver industry-leading financial performance.

Turning to slide 13, producing safe, quality, low cost, sustainable ton is a key part of our strategy and how we will differentiate ourselves. Though sustainability has long been a part of everything we do at Tronox, we are improving how we disclose our progress and efforts related to ESG performance, as it become increasingly critical for our stakeholder.

During the third quarter, we announced the reorganization of our board committee structure to enhance the oversight of ESG effort. We published our Annual Sustainability Report in July, which highlight our commitment to improvement for the future, including detail on plans to align with a global warming scenario below 2 degrees Celsius and achieve an aspirational goal of a net zero greenhouse gas emission and zero waste to external dedicated landfill by 2050. The report also feature the company's Journey to Zero, which is an initiative to achieve zero injury, zero incident, and zero harm. The enhanced oversight and increased disclosure is evidence of our ongoing commitment to ESG and sustainability.

Moving to slide 14, as we wrap up today's prepared remarks, I want to take a moment to review the outstanding position Tronox is in due to the dedication by our organization throughout the last several years. This would not be possible without our employees. So thank you to everyone for your ongoing effort.

This is a critical time for Tronox. With our portfolio of asset and market position, we are confident in our ability to continue to capitalize on our momentum and deliver on our commitment to our stakeholders. 2021 so far as been a great year for Tronox. We continue to navigate the current macro challenge while transforming our company, which will ensure our future remains bright.

That concludes our prepared remark. With that, I'd like to turn the call over for question. James?

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question-and-answer session. [Operator Instructions] Our first question today comes from Frank Mitsch from Fermium Research. Please go ahead with your question.

Aziza Gazieva

Analyst, Fermium Research LLC

Q

Good morning, guys. It's Aziza on for Frank. My first question was, can you walk us around the world and maybe explain how the TiO₂ dynamics are shaping up through the end of the year and into 2022, with particular interest on the North American pricing nominations and environmental crackdowns in China?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yes. This is John Romano. Thanks, Aziza. From the standpoint of the fourth quarter, again, we're not going to provide a lot of guidance on pricing. We did say that we would see increased pricing moving into the fourth quarter in line with what we've seen through 2021. And that would be globally. We're not just seeing pricing moving in one region. It's moving up in all regions. And with regards to demand, our demand continues or the demand continues to outpace supply. So when we think about where we are today in the current economic environment through 2022, we still are very optimistic about the volume growth. What's limiting our volume in the fourth quarter is strictly logistics issues.

And – okay. Sorry. And then your second question regarding China, there is a lot of discussion going on out there now around the dual-control energy and consumption policy that's in place. Our capacity has not been impacted. I would say that there has been some capacity that has been constrained. Our estimate has it at about 500,000 tons, and we would anticipate that to be to the fourth quarter based on what we know now. It's tough to speculate exactly what's going to happen with regards to China, but at this particular stage, we still see good demand there. It's strong. It's above our capacity to supply it. Again, for Tronox specifically, China only represents about 6% of our total sales on a volume basis.

Aziza Gazieva

Analyst, Fermium Research LLC

Q

Very helpful. Thank you for that. And for follow-up, can you provide any comments, concerns or [ph] mitigants (00:25:40) to the chlorine availability in the US following recent producers announcements to defer products from the TiO₂ industry? Thank you.

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

As we stated on the call, that was – we did have an issue in – earlier in the quarter, in the third quarter that has since been adjusted. We're getting plenty of chlorine now. Earlier in the year, we had – so one of the benefits of our vertical integration, we were able to actually modify our ore blend to offset some of that impact. But at this particular stage, we've addressed that issue and we're getting plenty of chlorine.

Aziza Gazieva

Analyst, Fermium Research LLC

Thanks, guys.

Q

Operator: Our next question comes from John McNulty from BMO Capital Markets. Please go ahead with your question.

John P. McNulty

Analyst, BMO Capital Markets Corp.

Yeah. Good morning. Thanks for taking my question. So it looks like between you guys having some issues in terms of production around supply chain and a whole host of others across the industry, it – we're at a point where inventories are really kind of at anemic levels at this point. I guess, can you speak to how long realistically it should take to kind of get the industry's inventories back on their feet again, especially given kind of what still appears to be a pretty strong demand environment just from a kind of normalized demand let alone from the inventory restock phase? I guess, how should we be thinking about that?

Q

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Yeah. Look, so I'll make a comment on that with regards to Tronox. We are running our assets as hard as we can at this particular stage. There have been some limitations. So to your point, we're well below seasonal norms on our inventory. Although we're – I think the effort would be to try to build a little bit of inventory to your point, because we need to maintain our service levels. But at this particular stage, definitely not before mid-year or next year do we see the inventory actually is starting to rebuild. There's lots of questions about what the supply chain is doing. We don't believe there's any inventory that's being built in the system of any significant amount. Again, it's hard to monitor every single customer, but at this particular stage, we have more inquiries coming in for volume than we can actually – that we can fill. So, we feel pretty confident that TiO₂ inventories are going to remain low for a period of time.

A

John P. McNulty

Analyst, BMO Capital Markets Corp.

Got it. And then can you speak to some of the supply chain issues that you're specifically having and when you think realistically those will be alleviated? And then – and I guess as a follow-up to that, I heard mentioned a 40,000-ton capacity increase in 2022 versus 2021. I didn't hear whether that was on the ore side or whether that was on the TiO₂ side. So if you clarify that, that would be helpful.

Q

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

So, John, maybe I can start with that. It's really on the pigment side, that's 40,000 ton of additional capacity for next year. So that's – sorry, we should have mentioned that. And on the other question that you had, I think that we resolved our chlorine issue, which is a good news for us. And going forward, we don't expect that to be a constraint for us. Being 85% vertically integrated, obviously, gave us a huge advantage in the market at the moment, because it's very tight for feedstock. And the fact that Jazan will start and that we are buying from all of the major producer, and, obviously, 85% come from our own mine. And as I mentioned, those mine and upgrading facility are running very well at the moment, so that help us on the supply chain side.

A

Look, our biggest challenge at the moment is energy price are like going to the roof. I mean, we had unexpected increase of natural gas, specifically in Europe that are coming in Q4. And look, that's always a challenge. We're working very hard to lower our costs, and we're very confident in the value that our project newTRON is delivering. But unfortunately, inflation is going faster than those cost reduction.

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

And we talk a lot about logistics too, and there's a cost element to that when we think about our fourth quarter kind of forecast. Unfortunately, we are actually using a larger percentage of uncontracted lanes than we would historically just to make sure we get those orders out. There's a shortage of containers out there. I'm not telling you anything you don't know. But the freight element of that is, I would say, not significant considering our global freight spend and that's on inbound and outbound.

John P. McNulty*Analyst, BMO Capital Markets Corp.*

Got it. Thanks.

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

Yeah. And again, just to make reference here, as we go into the balance of the year, we're obviously negotiating our contracted lanes and we believe some of that on the freight costs, at least from the standpoint of being out of line with what we would normally have on contracted lanes will be resolved as we move into 2022.

John P. McNulty*Analyst, BMO Capital Markets Corp.*

Got it. No, that's helpful. And maybe just if I can speak one last one, and just on Jazan, I understand like the earliest you can kind of officially take things on because everything ran well and passed all the tests is the end of 2022. Are there specific mile markers we should be looking at in terms of either operating rates or what have you that will get you and us comfortable that this is going to happen and even if it's before the fourth quarter that it feels like things are – the problems of the past are solved and it seems like this is getting to the finish line?

Jean-François Turgeon*Co-Chief Executive Officer & Director, Tronox Holdings Plc*

Look, John, look, we'll keep you informed as progress go. I don't think there's much we can add at the moment, because we haven't start. But look, it's a ramp-up of new technology. So, there's always things that could happen. We hopefully that it's going to be a smooth and successful ramp-up. But we've been conservative in our assumption of how much and how it's going to ramp up. So, I hope that helped, but we'll be able to talk more about it at the beginning of next year when we had a few months of operation behind ourselves. We're still in hot commissioning at the moment.

John P. McNulty*Analyst, BMO Capital Markets Corp.*

Got it. Thanks very much for the color.

Jean-François Turgeon*Co-Chief Executive Officer & Director, Tronox Holdings Plc*

First half is the first key.

John P. McNulty

Analyst, BMO Capital Markets Corp.

Got it. Okay. Thanks very much for the color. Appreciate it.

Operator: Our next question comes from Duffy Fischer from Barclays. Please go ahead with your question.

Duffy Fischer

Analyst, Barclays Capital, Inc.

Yes. Good morning. Since the Reuters article came out in early September, I mean really the only thing people want to talk about on you guys is the potential for Apollo. So could you talk about the genesis of that article and just your views on it?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Yeah. Look, I'll take that one, and it's going to be a short answer. We don't part – we're not going to comment on market speculation about that article. So, that's all we can really say about that.

Duffy Fischer

Analyst, Barclays Capital, Inc.

I understand that. But, I mean, you guys are doing are doing yourselves a disservice, because nobody can really invest unless they have a view on that. So I mean, just saying nothing, I think, hurts the story. So, again, just my view on it. So, then, you guys talked about inflation on energy. Can you talk about geographically or maybe by plant, where is natural gas versus where is electricity the issue?

Timothy Craig Carlson

Chief Financial Officer & Senior Vice President, Tronox Holdings Plc

Yeah. Duffy, thanks for the question. I did want to highlight before I talked about the transitory headwinds in Q4 that the teams that we have globally have done a great job in offsetting the inflationary [ph] putting (00:33:18) commodity costs increase in Q3 through our cost-saving programs and our cost controls. Natural gas itself is nearly going to be about a \$10 million headwind for us in Q4, primarily in the UK, is our biggest increase there. Commodities themselves are another about a \$10 million headwind, primarily coke, sulfur, sulfuric acid, sulfur issues primarily in Brazil. And then we've got just general cost inflation through the rest of the network that we've offset a good chunk of it that we're saving so far this year. There's just so much savings that we have in the plan in Q4, but we've got additional savings next year, obviously, with newTRON and with ongoing savings.

So, overall, headwinds from a cost standpoint between natural gas, commodities, and the freight issue that John talked about in terms of going to non-contracted lanes is about a \$30 million headwind in the quarter. But despite those headwinds, Duffy, we still remain very confident in our ability to expand margins in 2022.

Duffy Fischer

Analyst, Barclays Capital, Inc.

Great. Thank you, guys.

Operator: Our next question comes from David Begleiter from Deutsche Bank. Please go ahead with your question.

David Begleiter

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Just on China, can you discuss the impact you see on the cost curve over there the last few quarters? And what's your thought on capacity, because that could be at risk throughout 2022, given dual control and power curtailments?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. As far as fourth quarter goes, we mentioned it briefly, at this stage, our internal estimate is that there is about 550,000 tons that has been impacted by that. A little bit hard to say how that's going to run into 2022, but there's no question that the dual-control energy consumption policy, along with a colder winter, we've already got some indications that there could be some power restrictions attached to colder months that happens every year.

With regards to cost, I mean, cost in China are largely being driven by feedstock and sulfur, and that's up significantly and it's been up for a period of time. We haven't seen really any change in the feedstock market. Feedstock's going to continue to be, in our opinion, tight on both the sulfate side and the chloride side. So, I don't know, JF, do you want to make any additional comment?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Maybe I made the comment that this – those power interruptions and the extra effort on the environment has had a very important limiting production impact on the ilmenite production in China. And that's why the price of ilmenite remains very high. And we don't expect that trend to change with that pressure on this. And the other thing is, ilmenite production in China is highly linked to iron ore production. And with the reduction in iron ore price, there's less incentives to produce more ilmenite for those mining company, and that also push the price of ilmenite high and maintain it high.

David Begleiter

Analyst, Deutsche Bank Securities, Inc.

Q

Very good. And just on capital allocation, how does share buyback figure into your future plans to deploy capital?

Timothy Craig Carlson

Chief Financial Officer & Senior Vice President, Tronox Holdings Plc

A

In principle, getting to our \$2.5 billion target continues to be our number one priority, but we expect to get there in Q1. We'll provide a lot more details as part of our year-end call in terms of specific capital allocation. But with that being said, we do expect to generate significant free cash flow next year, and we remain committed to returning capital to shareowners, while being prudent to ensure that increases in dividends that we make, we'll make sure that every and each increase is sustainable. And with that being said, I do believe we'll have additional free cash flow for share repurchase targeting dilution from the equity compensation and also targeting the dilution from the 7 million shares that Exxaro issued.

David Begleiter

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: And our next question comes from Josh Spector from UBS. Please go ahead with your question.

Joshua Spector

Analyst, UBS Securities LLC

Yeah. Hi, guys. Thanks for taking my question. Just a quick follow-up on the cost side, when you lay out the higher costs specifically on the energy side in the fourth quarter, if costs stay elevated, is there another leg of that to come in first quarter, or is all of that baked into your fourth quarter comments?

Timothy Craig Carlson

Chief Financial Officer & Senior Vice President, Tronox Holdings Plc

Yeah. So we do believe the energy costs are transitory, just given the current natural gas curves that you see in the marketplace, some of it will roll into Q1 just given the winter season in the UK, but the cost curves do come down quite a bit. But with that being said, as John mentioned earlier, we are also confident on our ability to pass these costs on within the channel.

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Look, I would add on that, Josh, that in the UK, it's not sustaining the price of natural gas at the moment. There's many plants that were shut down because of the cost of natural gas being so high and had been moving so quickly. Look, we're lucky because with our cost reduction initiatives and the fact that we were able to increase our own price, we're still running successfully in the UK, but we expect that it's going to improve in 2022, as Tim mentioned.

Joshua Spector

Analyst, UBS Securities LLC

Okay. No, I understood. Just was wondering if there is some inventory timing issues, but that's fair. And just as a follow-up, when I look longer term and the back integration that's kind of key to your strategy, I mean you guys are investing in Atlas to help you get the materials needed for the next few years. I guess, I wonder if I look out 5, 10 years, is there another Atlas-type investment that needs to happen to maintain that back integration, or does Atlas get you further than that?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

So, Josh, it's a very good question and, look, like any mine, they have a life. So, obviously, Atlas Campaspe will give us a good 10-year and more of production. So, this is there and the investment will be complete next year. But within our five-year plan, we have some investment to do in South Africa to continue to have the level of vertical integrations that we have, and that's a – the good news is we have project to sustain that vertical integration for more than 20 years with our resource and reserves already in our hands, if I could use that expression.

Joshua Spector

Analyst, UBS Securities LLC

Got it. Thank you.

Operator: Our next question comes from Matthew DeYoe from Bank of America. Please go ahead with your question.

Matthew DeYoe

Analyst, BofA Securities, Inc.

Q

Good morning. Thanks. Have you seen any shift in the availability of upstream ores? I know, we – in general, it's been tight right? But we had a pretty significant outage during the summer and one of your other competitors is committed to bringing down their asset in 4Q. So I'm just wondering if you've seen a pickup in market activity trading or anything that would lead you to be concerned about raw material availability more broadly on the ore side?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. Look, it's – clearly, the ore market has been tight for an extended period of time and some of the disruptions that happened in South Africa did not, I wouldn't say, improve that, made it – I would – exacerbated it. And from our standpoint, as we've stated, we're 85% vertically integrated. We've got feedstock managed internally and we also buy feedstock on the external market. So it's a challenge for us. It's not as much of a challenge clearly for us as we're 85% vertically integrated. And then as JF mentioned earlier, we've also got the opportunity coming up with Jazan [ph] first half (00:42:02) the slag coming in the fourth quarter. JF?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. No, look, I think, Matthew, what we could say on that is it's a market that we track closely. We want to make sure that we're always ready for the coming year. So it's not something that we manage quarter-by-quarter, but we try to have a full year view.

Matthew DeYoe

Analyst, BofA Securities, Inc.

Q

Okay. And...

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

I think the timing of our Atlas Campaspe mines starting is also very good for us.

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. I think it's just a good point, when we think about a five-year plan, for us, you've got a five-year plan for the business that's supported by a 20- to 30-year plan to JF's point on the feedstock. So feedstock is something that we spend a lot of time on.

Matthew DeYoe

Analyst, BofA Securities, Inc.

Q

Yeah. Kind of to build on that, is there any shortfall in integration as you transition away from Snapper and Ginkgo to Atlas Campaspe, or is that expected to be fairly seamless? Like, what should we see on the financial statements from that whole transition [indiscernible] (00:43:07)?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

No that's – yeah. No, that's a good question, and it's a seamless transition. And obviously, as Atlas ramp up, there's more benefit in Atlas, because it's a new mine. And like every mine, when you end the life of a mine, you have higher cost and lower grade. But when you start a new mine, you have the high-grade zone that you start to exploit. And we're going to have more production of rutile and zircon as the Atlas Campaspe start.

Matthew DeYoe

Analyst, BofA Securities, Inc.

Q

All right. Thank you.

Operator: Our next question comes from Hassan Ahmed from Alembic Global. Please go ahead with your question.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Good morning, guys. I just wanted to revisit some of the commentary you made on feedstocks. You talked earlier about resolving the chlorine issues. I just wanted to sort of dig deeper into what you mean by that. I mean, contractually have you gotten into sort of longer term volume contracts? If you have, I mean is it based on some sort of formula-based pricing, just if you could help me think through the contractual nature of these things and the duration of any contracts you may have struck?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Thanks, Hassan. Look on the chlorine, that was not a contract issue. That was a supplier that filed a force majeure. And we were able to manage less of the, I guess, the decreased volume specifically in Hamilton on chlorine by managing our head grade. So we were able to adjust the head grade, use higher TiO₂ content ore to offset some of that. Towards the end of that process, we did have a little production issue, which we've referenced, that's been resolved. So the chlorine issue wasn't a contract issue, it was a force majeure and now we're getting chlorine, which more than offsets what we need for that particular facility.

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. And, Hassan, John talked about the force majeure in the US, but we also had a chlorine issue in the UK, because there was a power cut. And there's only one chlorine plant in the UK, and obviously the plant was affected by that loss of power and that gave us a few issue. And those two happened at the same time, unfortunately. But those two event are resolved now and we feel that we're in a good position.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

Q

Understood. Understood. And as a follow-up, I understand there are sensitivities around the Reuters article and the like. So completely cognizant of that. BUT there was a very specific number given, \$27 a share, right? Can you broadly talk about how you think about valuation as it pertains to Tronox? I mean, look, the fact of the matter is, you guys are in a very unique situation where you have multiple levers, and what I mean by multiple levers is obviously there seems to be a new baseline set for normalized earnings for you guys. So one can sort of assess valuation based off of that, then you guys are generating ample free cash flow. You are delevering, so that

obviously helps that valuation as well. You have NOLs. You have the Jazan option, which are all sort of valuation accretive. So can you just help me think through how you internally are thinking about valuation, particularly with your stock price where it is, with the speculated \$27 number that Reuters talked about and the like?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Well, Hassan, I'll tell you, you almost answered the question for yourself. So, you did a good job on that.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

That's why they pay me the big bucks.

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Yes. We're not going to speculate, again, on the rumor, but I think a lot of where we are at this particular stage is we do believe we've been undervalued. And our strategy, as we have been doing everything with regards to our – one of our most important targets was reducing our debt and we've done that through extremely strong cash flow. All the work that we're doing on our project newTRON to reduce cost is going to help us continue to have lower cost as we move into 2022. It's not just about cost and margin expansion though, we also are confident as we move into 2022 that we're going to have growth in our EBITDA. So Tim, do you want to make a comment?

Timothy Craig Carlson

Chief Financial Officer & Senior Vice President, Tronox Holdings Plc

No, I think you've summarized it very well, John.

Hassan I. Ahmed

Analyst, Alembic Global Advisors LLC

All right. Thank you, guys.

Operator: [Operator Instructions] Our next question comes from Vincent Andrews from Morgan Stanley. Please go ahead with your question.

Hi, guys. This is [ph] Will Payne (00:48:11) on for Vincent. Just some question on the demand side. Given paint [indiscernible] (00:48:17) right now, are you seeing that impacts the buying patterns of your paint customers that they're slowing down purchasing, or has their demand been relatively unaffected? And then, can you talk about the extent to which shortages of raw materials are impacting demand from other customers and other industries as well?

Jennifer Guenther

Vice President-Investor Relations, Tronox Holdings Plc

I'm sorry. [ph] Will (00:48:37), can you repeat the first part of your question? It was a bit muffled.

Q

Yeah. So, I mean, paint [indiscernible] (00:48:44) are really short right now. So, are you guys kind of seeing that impact the buying patterns of your paint customers, and that there's slowing down purchasing, or has their demand been relative unaffected?

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

Yeah. I think I got that question and the short answer is yes. We had seen some, I'd say, specifically in North America, some reduction in the third quarter. That being said, we're starting to see a pickup in that volume moving into Q4. And that shortage, I would say, of – I guess, on other raw materials that were impacting some people's capability to produce coatings, for us, we exported a lot more of that TiO₂ to other markets where it wasn't an issue.

So, from the standpoint of where we are today with – even with that disruption in the coatings industry that came from other raw materials, we were still well oversold and we redistributed the volume and, again, we distributed that volume into other areas where demand required it was exacerbated by the logistics issues that we've referenced.

So, I think the short answer is, we do believe a lot of that's been resolved. You've probably heard some of the earnings calls of some of the larger coatings companies, which have indicated that. And we're seeing a healthy demand in North America for coatings moving into the fourth quarter and beyond.

Q

Got it. And then just as a follow-up question, I mean, given all the volatility and moving parts in the supply chain, is there any risk to kind of achieving your [ph] newTRON (00:50:16) target by 2023? Or are [indiscernible] (00:50:20) those savings regardless of external conditions?

Jean-François Turgeon

Co-Chief Executive Officer & Director, Tronox Holdings Plc

A

We still very commit to those saving, and we could measure those and we could track those and we're confident. They're not really related. Look, obviously, the inflation could alleviate those saving, but the savings are real, specifically when we talk about improving our maintenance, the automation of our plant, and the digitalization of our assets. Look, all of those transformation are real and will help our cost position. And we're still committed to those.

Q

Thank you.

Operator: And ladies and gentlemen, with that, we'll conclude today's question-and-answer session. At this time, I'd like to turn the floor back over to John Romano for any closing comments.

John D. Romano

Co-Chief Executive Officer & Director, Tronox Holdings Plc

Thank you. And thank you, again, for joining the call today. I think we'd just like to end with a little bit clearly fourth quarter, a little bit of challenge moving into that, but maybe more longer term moving into 2022, we are very optimistic about 2022. There's a significant amount of work that's gone into the projects that JF outlined with regards to cost savings opportunities and our ability to increase our capacity to meet the demand of our customers, along with where we are in the economic cycle. We think we're early in an upcycle from the standpoint of our ability to actually continue to generate additional margin enhancement as well as EBITDA growth moving into 2022.

So, thank you, again, for your time and have a good day.

Operator: Ladies and gentlemen, with that, we'll conclude today's conference call. We do thank you for attending. You may now disconnect your lines.

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