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Chemicals - Major (Citi)  
North America | United States

# TiO2 Industry Update & TROX 1Q13 Post Call Recap

■ High Yield

## TiO2 Flu Running its Course

- **TiO2 Industry Update** — Volume, operating rates, and inventory data suggest stabilization in 2H13.
- **Tronox (TROX) 1Q13 Recap** — TROX released results and hosted a conference call on Thursday May 9<sup>th</sup>. Management believes an end to destocking will lead to improved conditions in 2H13, which is in line with what we've heard from other industry participants this earnings season. TROX continues to evaluate strategic opportunities to take advantage of its vertical integration post its acquisition of Exxaro's mineral sands operations in 2012.

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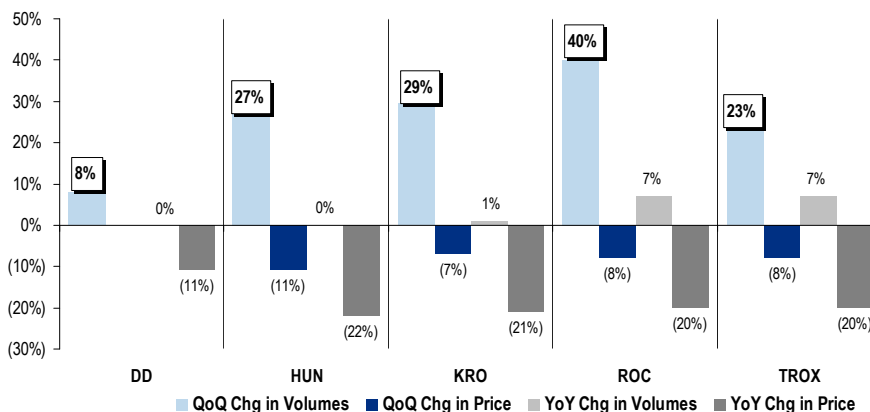
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## TiO2 Industry: Volumes Up & Inventories Down

- **Trends Point To Stabilization** — Volume, operating rates, and inventory data suggest stabilization in 2H13.
- **Volumes up QoQ** — Volumes were up noticeably sequentially and some players actually posted year over year gains (Figure 1).
- **Operating Rates at Depressed Levels** — Reported operating rates for 1Q13 ranged between 60% and 92% which are up QoQ, though they remain below peak levels. HUN has stated that they believe the industry is currently operating at ~80% up from low to mid 70s over the last few quarters.
- **Inventories Down** — The increased volumes and lower operating rates have helped make a dent in excess inventories (see Figure 7). HUN sees the industry currently having ~75 days of inventory on hand, which is down from ~100 days at YE12.
- **Demand** — On the demand side of the equation, we see the recovery in the U.S. housing market as a tailwind for the TiO2 industry (Figure 8).
- **Supply** — On the supply front, DD stated at their 2013 investor day held last week that they don't believe China will be a significant exporter on a go forward basis highlighting that under China's 5-yr plan the industry is not designated for export growth given the environmental waste associated with the sulfate process. Note that DD is also planning to add 200k tons of capacity at their Altamira, Mexico facility. The new DD capacity is scheduled to come online in 2015.
- **Cost** — Raw material costs are still up over 100% since the beginning of 2011 despite having falling 40% from peak levels (Figure 9). The expiration legacy below market contracts should support TiO2 prices.
- **Bottom Line** — While prices are down ~20% year over year, we believe that a return to normal inventory levels should lead to price stabilization in 2H13 and history has shown that volume gains tends to lead to pricing power (Figure 4). Despite the challenging environment, we have actually seen 3 price increases announced in 2013 (Figure 10).

Volumes spike QoQ in 1Q13

Figure 1. Industry TiO2 QoQ Volume and Price Trends for 1Q13



Note: DD did not report QoQ % Price Change.

Source: Citi Research, company filings, presentations and conference calls.

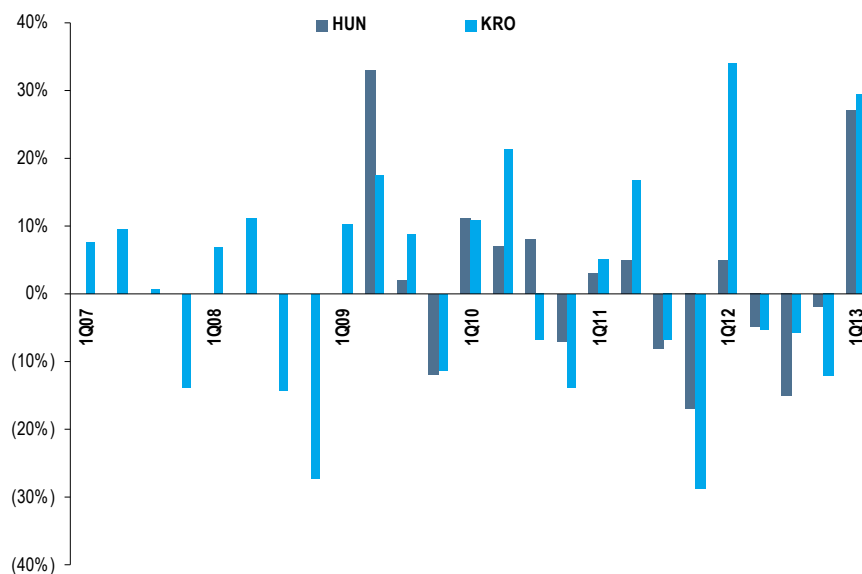
Figure 2. TiO2 Data Points

Ticker	DD	HUN	KRO	ROC	TROX
QoQ Chg in Volumes	8%	27%	29%	40%	23%
QoQ Chg in Price	na	(11%)	(7%)	(8%)	(8%)
YoY Chg in Volumes	0%	0%	1%	7%	7%
YoY Chg in Price	(11%)	(22%)	(21%)	(20%)	(20%)
Days of Inventory	Still 10-15 days excess inventory on producer side...should be worked off by end of 1H13.	45 days at end of 1Q13 vs. 75 days at YE12. Industry has declined to 75 from > 100 at YE12.	68 days at end of 1Q13 vs. 102 at YE12.	1.5 months greater than normal at end of 1Q13.	71 at end of 1Q13 from 81 at 4Q12. Expect to reach normalized 50-55 days by end of 2Q13.
Operating Rate	Did not offer any specific commentary.	Industry currently at ~80% up from low to mid 70s over last couple of quarters.	92% in 1Q13, 80% in 4Q12, 71% in 3Q12, 86% in 2Q12.	60-70% in 1Q13; expect to trend lower in 2Q13.	Remained in mid 70s in 1Q13 vs. 75% at YE12 and 70% at 3Q12.

Source: Citi Research, Company Filings, Presentations and Conference Calls.

1Q13 volume improvement > seasonal gains typically seen in 1H of yr

Figure 3. Historical QoQ % Change in TiO2 Volume: HUN and KRO

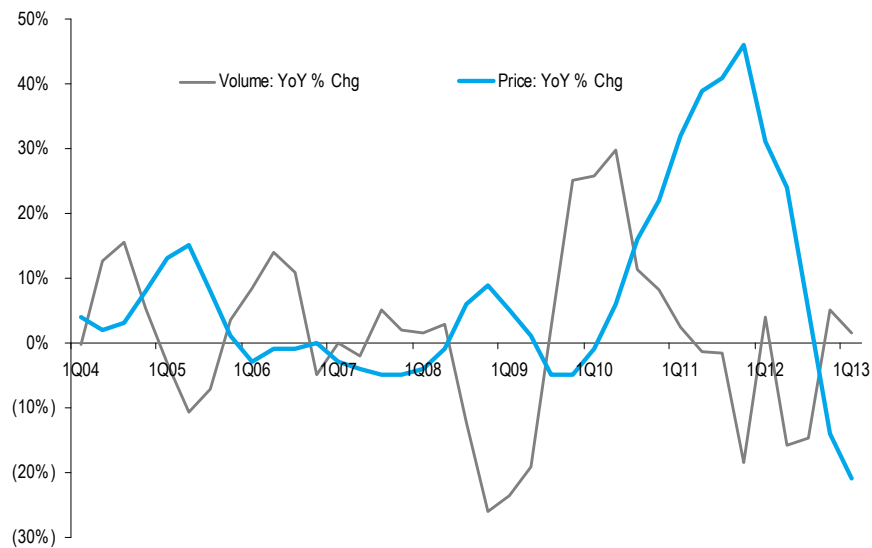


Note: HUN QoQ % change in volume only available since 2Q09.

Source: Citi Research, Company Filings, Presentations and Conference Calls.

*Volume improvement has historically preceded price gains*

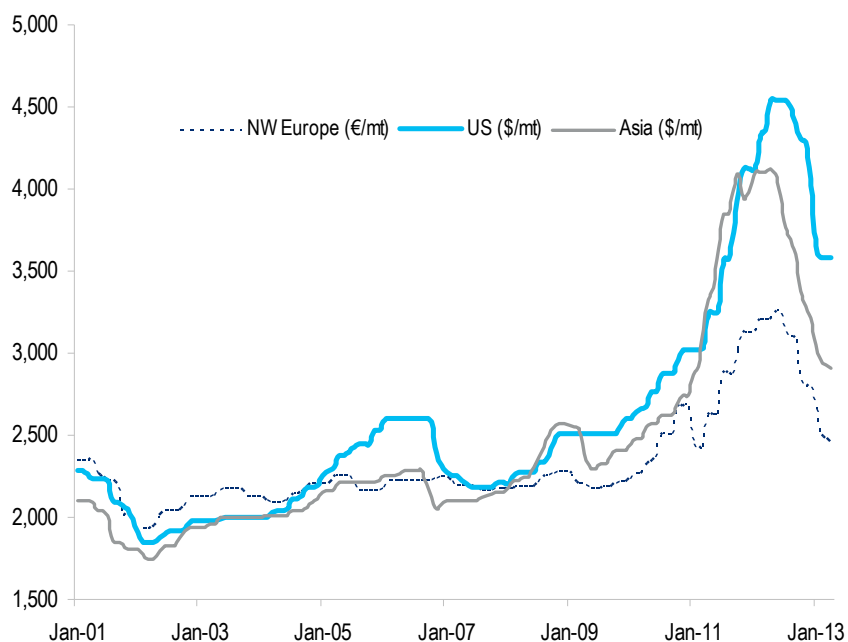
Figure 4. Kronos (KRO) Historical Volume and Price Trends (YoY %)



Source: Citi Research and Company Filings.

*Pace of price declines slows*

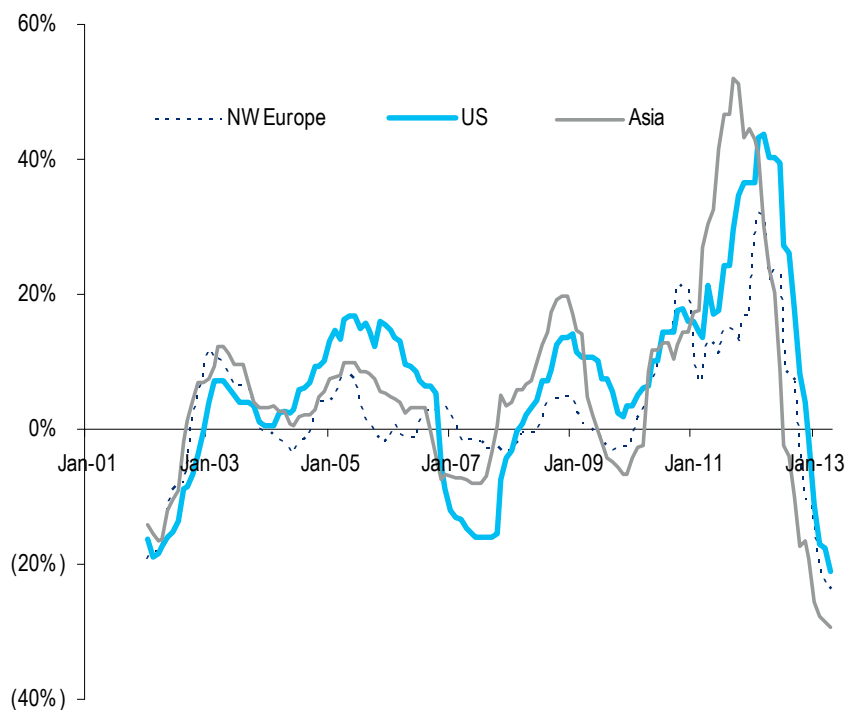
Figure 5. Global TiO2 Price Trends



Source: Citi Research, ICIS.

*Prices are down ~20% YoY post 40 plus  
% YoY gain in 2011/12*

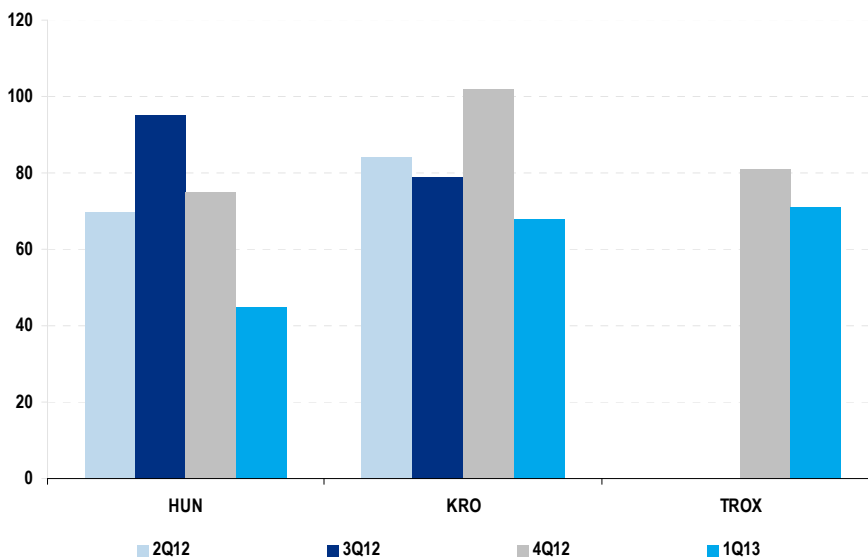
Figure 6. YoY % Change In Global TiO2 Prices



Source: Citi Research, ICIS.

*TiO<sub>2</sub> Inventory is declining*

Figure 7. Days Inventory of TiO<sub>2</sub>: HUN, KRO and TROX

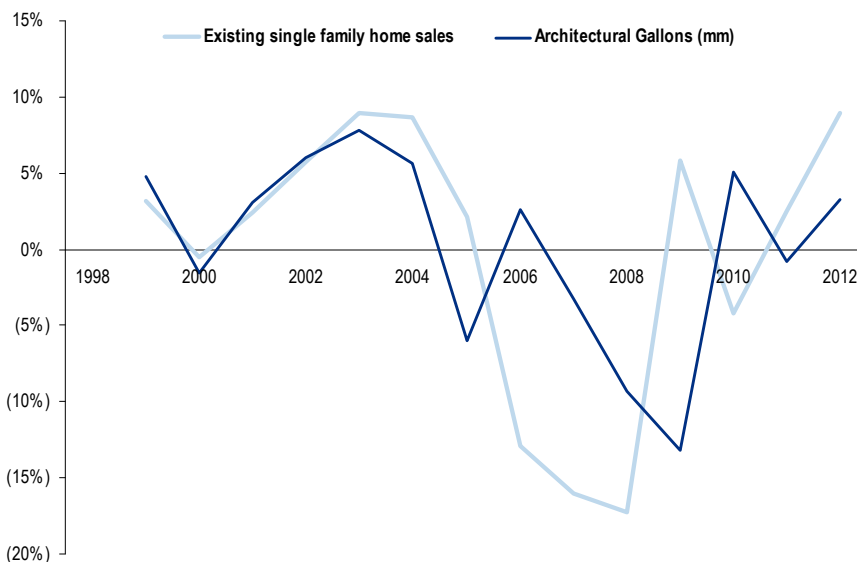


Note: TROX data no available for 2Q/3Q12.

Source: Citi Research, Company Filings, Presentations and Conference Calls.

*Rebound in U.S. housing industry is a tailwind for coatings (key end market for TiO<sub>2</sub>)*

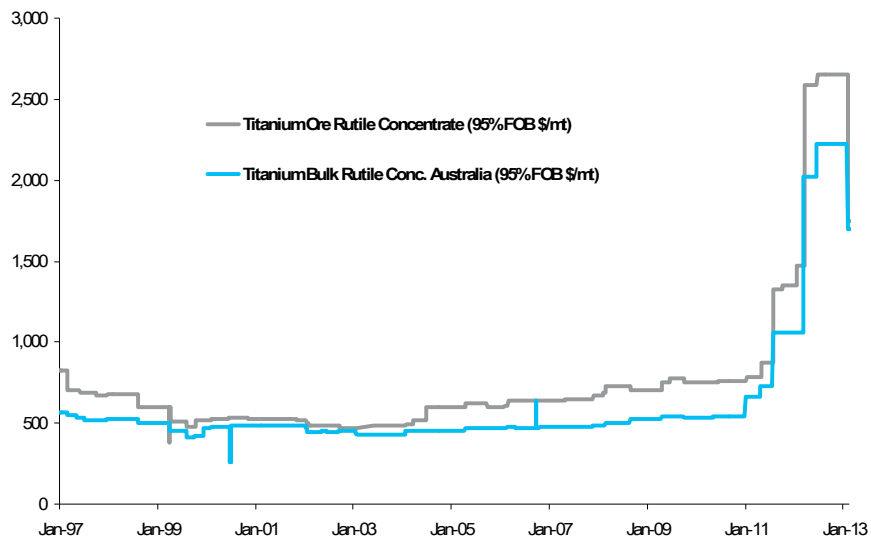
Figure 8. Annual U.S. Existing Single Family Home Sales vs. Architectural Gallons (YoY % Chg)



Source: Citi Research, Census bureau and company reports.

*Raw material prices are up > 100% since Jan-11 despite having fallen ~40% from peak.*

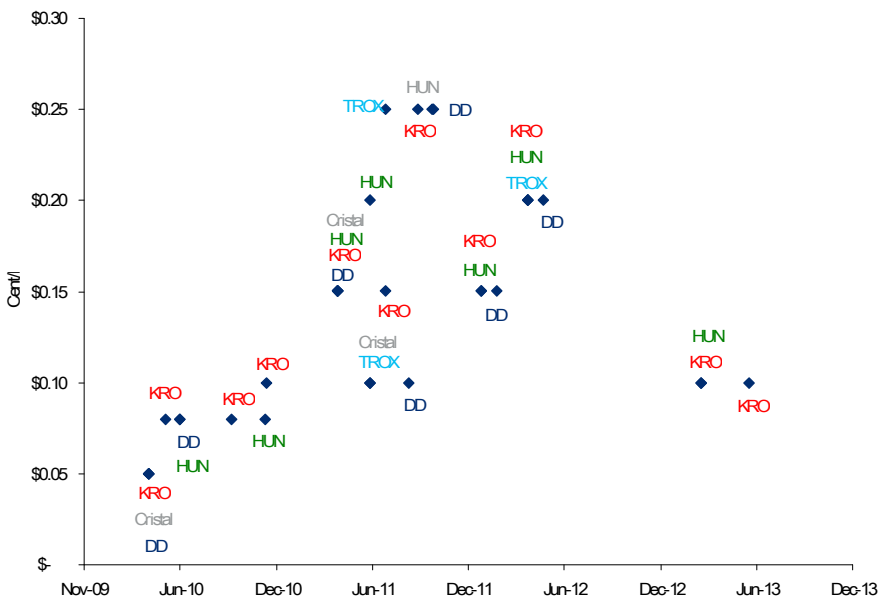
Figure 9. Titanium Ore Prices



Source: Citi Research, Bloomberg and Metal Bulletin.

3 price increases announced in 2013.

Figure 10. North American TiO<sub>2</sub> Price Increase Announcements



Source: Citi Research and company reports.

■ **Relevant Credit Research**

- 4/30/13: [Huntsman \(HUN\) 1Q13 Post Call Recap - TiO2 Inventories Down & Volumes Up Sequentially](#);
- 4/20/13: [Rockwood \(ROC\) 1Q13 Post Call Recap - ROC-Paper-Scissors: 3 Segments Remain in Play](#)
- 4/17/13: [High Yield Chemicals 1Q13 Earnings Preview](#).
- 3/18/13: [Tronox Ltd. \(TROX\) - T-ROX On the Hunt](#)

■ **Relevant Equity Research**

- 5/2/13: [E I du Pont de Nemours and Co \(DD\) - Not Quite Ready to Make a Clean Break from Commodities; Analyst Day Focuses on Innovation](#);
- 4/29/13: [Chemicals 1Q13 Insights - "Green Shoots" in US Commercial Demand, but Another Leg Down in Europe](#)



## Tronox (TROX) 1Q13 Post Call Recap

- **Overall Takeaway** — TROX (TROX; OW) 1Q13 sales beat estimates while EBITDA fell short of consensus. Operating results were driven by volume growth in Mineral Sands, though offset by softness in Pigments. CEO expects global market for pigments to strengthen in 2H13 and reiterates ongoing evaluation of strategic opportunities for TROX to expand scale. We reiterate Buy on the 6.375% Senior Notes due 2020 (2/BB-).
- **1Q13 Key Statistics** — See TROX Earnings Summary in Figure 1.
  - **Sales:** \$470mm (-20% YoY PF) vs. our estimate of \$425mm (Street at \$429mm).
    - TiO<sub>2</sub> Volumes +23% QoQ; at highest level since 3Q11. Volume gains strongest in N.A. & Asia.
    - Zircon Volumes +47% QoQ post 4Q12 sequential gain of 93%.
  - **EBITDA:** \$73mm (-73% YoY PF) vs. our estimate of \$75mm (Street at \$91mm).
  - **Debt/EBITDA:** stepped up to 4.4x from 3.3x in 4Q12 (PF TL Add-On).
  - **Net Debt/EBITDA:** stepped up to 1.9x from 1.3x at 4Q12 (PF TL Add-On).
- **Conf. Call Highlights** — Focus on Inventory Destocking and M&A.
  - **Replay:** 855.859.2056, Pin 41214936.
  - **M&A:** CEO stated they have viewed assets with sulfate production capacity which they could supply feedstock into. Not interested in acquiring assets that would not build upon vertical integration. Some options wouldn't necessarily help with monetizing US based NOLs. Management indicated broadly they have 3 choices for utilizing cash balance:
    1. Invest in Pigment business (Brownfield or Greenfield expansion).
    2. Invest in Mineral Sands business (Brownfield or Greenfield expansion)
    3. Acquire operating assets from a 3<sup>rd</sup> party (highlighted ROC assets).
  - **Capex:** See annual capex for 2013-15 in the range of \$200-250mm (\$100-120mm maintenance, \$100-130mm Fairbreeze mine development).
  - **DD&A:** See FY13 DD&A in the range of \$290-310mm.
  - **Vertical Integration:**
    - **Mineral Sands:** 69% of feedstock revenue derived from intercompany sales in 1Q13, up from 59% in 4Q12. Legacy contract to sell 40k tons of CP slag to a 3<sup>rd</sup> party expired in 4Q12. Another contract for 100k tons with a chloride based TiO<sub>2</sub> producer set to expire at end of 2013.
    - **Pigment:** Pigment purchasing almost all of its feedstock from Mineral Sands since the merger closed in June 2012.
    - **Accounting:** Feedstock inventories in Mineral Sands stepped up to market value (+\$188mm) at time of closing. Approximately 25% of this stepped up inventory remains on the books. Pigment's internal purchase of feedstock from Mineral Sands will be recorded at current market/spot price. Pigment segment will not reflect aggregate margin increases from the vertical integration. Instead, it will reflect the *highest feedstock costs* of any pigment producer. Management expects recovery of the margins "lost" in the Pigment segment to be reflected in the consolidated results. Expect to capture more feedstock margin in 2Q13 than in 1Q13.

- **Long Ore Position:** 211k long position sold into 3 buckets.
  1. *Legacy Contract:* 100k tons sold to the 3<sup>rd</sup> party (chloride producer; contract expires at YE13).
  2. *Non-Pigment Market:* natural rutile for welding and other titanium metal.
  3. *Other Chloride Producers.*
- **Utilization Rate:** Unchanged sequentially (mid 70s). TROX had 71 days of inventory at the end of March; sees higher operating rates when inventory levels come down to the 50 to 55-day level which they hope to reach by mid year.
- **TiO2 Prices:** Expects stabilization once excess inventories are worked off.

Figure 11. TROX 1Q13 Earnings Summary

	Actual 1Q13E	Street 1Q13E	Street Range	4Q12 PF	SEQ % Chg	1Q12PF	YoY % Chg	Comment
Revenue	\$470.0	\$429.0	\$377-\$455	\$482.0	(2.5%)	\$589.0	(20.2%)	Beat
EBITDA	73.0	\$90.5	\$86-\$95	71.0	2.8%	270.0	(73.0%)	Missed Street...Inline with our estimate.
Adj EPS	(\$0.45)	(\$0.21)	(\$0.25) - (\$ 0.16)	(\$0.40)	12.5%	\$1.25	(136.0%)	Miss
EBITDA (%)	15.5%	21.1%		14.7%	80bp	45.8%	-3,031bp	
Total Debt	2,411.0			2,454.0	(1.8%)	700.0	244.4%	4Q12 PF issuance of \$1.5B TL.
Net Debt	1,036.0			936.2	10.7%	377.0	174.8%	
LTM EBITDA	545.0			742.0	(26.5%)	975.0	(44.1%)	
Debt/EBITDA	4.4x			3.3x	1.1x	0.7x	3.7x	
Net Debt/EBITDA	1.9x			1.3x	0.6x	0.4x	1.5x	
Cash	1,375.0			1,517.8	(9.4%)	323.0	325.7%	4Q12 PF issuance of \$1.5B TL.
SALES	1Q13E	Citi HY		4Q12 PF	SEQ % Chg	1Q12PF	YoY % Chg	Comment
Mineral Sands	298.0			316.0	(5.7%)			Zircon REV +6% QOQ (Volume +47%, Price -28%) TiO2 Volumes +23% QoQ, Price -8% QoQ
Pigment	288.0			256.0	12.5%			
Corporate	27.0			31.0				
Eliminations	(143.0)			(121.0)	0.2			
<b>TOTAL SALES</b>	<b>\$470.0</b>	<b>\$425.0</b>	<b>10.6%</b>	<b>\$482.0</b>	<b>(2.5%)</b>	<b>\$589.0</b>	<b>(20.2%)</b>	
Mineral Sands	157.0			154.0	1.9%			Feedstock cost of \$1,501/MT vs. \$1,623/MT in 4Q12.
Pigment	(37.0)			(58.0)	nmf			
<b>TOTAL EBITDA</b>	<b>\$73.0</b>	<b>\$75.0</b>	<b>(2.7%)</b>	<b>\$71.0</b>	<b>2.8%</b>	<b>\$270.0</b>	<b>(73.0%)</b>	
Mineral Sands	52.7%			48.7%	395bp			
Pigment	(12.8%)		-1,285bp	(22.7%)	981bp			
<b>EBITDA Margin</b>	<b>15.5%</b>	<b>17.6%</b>	<b>-212bp</b>	<b>14.7%</b>	<b>80bp</b>	<b>45.8%</b>	<b>-3,031bp</b>	

Source: Citi Research, Company Filings and Presentations, First Call.

## Appendix A-1

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High Yield Credit Research

Analyst: James P Finnerty

Issuer		Issue			
Weighting	Date	Coupon	Description	Maturity	Rating
OW	24-Oct-12	6.375%	Sr Nts	15-Aug-20	Buy (1)

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