15 April 2019

Quarterly Review March 2019 - Teleconference Transcript

Presenters/Speakers

- **Tom O'Leary** – Managing Director and CEO
- **Matthew Blackwell** – Head of Marketing and Procurement

Start of Transcript

Operator: Ladies and gentlemen, welcome to Iluka Resources March 2019 Quarterly Report conference call. There will be a presentation followed by a question and answer session. At which time if you wish to ask a question you will need to press star-one on your telephone.

I must advise you today's conference is being recorded, on Monday 15 April 2019. I would now like to hand the call over to your first presenter today, Mr Tom O'Leary, Managing Director. Thank you, please go ahead.

Tom O'Leary: Thank you. Good morning and thank you for joining us. Today with me I have Adele Stratton, CFO, Matthew Blackwell, Head of Marketing and Procurement, and Melissa Roberts, General Manager Investor Relations and Commercial.

I will provide a short summary of our March Quarterly, which was released this morning, and then open up the line for questions.

First on production, you will note that our combined zircon, rutile, and synthetic rutile production of 154,000 tonnes in the first quarter was down around 17% from the December quarter last year. That was in line with our expectations and there were several reasons for it.

Most significantly our synthetic rutile kiln in the South-West underwent a planned major maintenance outage during the quarter, ahead of its next four-year campaign. That meant that the kiln was offline for around 45 days. Though nearly a week short of the planned outage of 51 days, thanks to the planning and hard work of the operations team.

The kiln has now been successfully returned to production and is processing stockpiled ilmenite ahead of processing the feed stocks from our new Cataby mine.

At Sierra Rutile we decommissioned the dredge in February. That permanently removed that source of production from our operations in Sierra Leone. The dredge was over 40 years old and we had already extended its life by more than a year beyond the original plan at the time of acquisition.

The decommissioning was completed successfully and safely, and with close consultation with both the union and government.

Despite the decommissioning of the dredge rutile production was higher from Sierra Leone, up a little from the December quarter.

Operational improvements have been made at the Lanti and Gangama sites following the disappointing production result last year. We have started seeing encouraging results in throughput, particularly at the in-pit mining unit at Lanti. But we still have more to do. The team has turned its attention to increasing run times.

At Jacinth-Ambrosia we continue to operate well, delivering 156,000 tonnes of heavy mineral concentrate during the quarter. Sales in the quarter were down from the December quarter, although I note that decline is also in line with our expectations.

With inventories having returned to normal levels through 2018, so that going forward sales ought to be broadly in line with production. The planned kiln outage I've touched on meant that as planned synthetic rutile sales were lower. Also two synthetic rutile shipments budgeted for March were pushed out into April, just a logistics outcome. So they will be recorded in the June quarter sales.

To zircon markets. We highlighted last year, and at the time of the full year result, that we were anticipating a slower start to the year for zircon sales in line with historical seasonal norms. That has eventuated. But our view continues to be that underlying demand is sound.

Across China and more broadly including Europe, trade and political tensions are creating some uncertainty and leading to a cautious approach to buying. However inventories throughout the value chain have now been depleted. We expect to see more robust sales activity returning over the course of the year.

In China further ramp up for the ceramic plants following the Chinese New Year period should also support demand in the region.

Positively for Iluka some suppliers or zircon have experienced difficulties in supplying premium grade zircon product. Iluka is more heavily weighted to that market, with production from our Jacinth-Ambrosia operations. That short-term supply tightness if expected to provide further support for our zircon sales.

The high grade feedstock market continues to remain strong, with the pigment market reporting a solid start in 2019. High grade feedstocks are an important part of the blend fed into pigment plants, most of which are currently running at high rates of utilisation.

As we have stated in the quarterly, the market remains in a state whereby we can't meet all the enquiries for volumes of our titanium products.

Now turning to our projects. I am pleased to report that across our portfolio of major projects we have continued to progress on schedule and budget.

The Cataby development is all but complete. Commissioning is well advanced, and the project team is expected to officially hand over the site to our operations team this week. Heavy mineral concentrate has been produced at the site and we have begun trucking material to our operations in the South-West.

The Lanti and Gangama expansions are progressing as planned. Construction of the second Gangama concentrator is nearing completion. With the cessation of dredge mining relocation and reconditioning of the floating concentrator for re-use at Lanti has begun.

The Sembehun and mineral separations plant upgrade projects at Sierra Rutile value optimisation work is continuing. I expect that we will be able to inform the market of our preferred development approach in the second half of the year.

You may have noticed that we have added a new project to our commentary this quarter, the Eneabba tailings project. Iluka has a significant stockpile of tailings materials at Eneabba, near Geraldton in Western Australia. That stockpile was built over many years from remnant material from the Narngulu mineral separation plant.

The stockpile is rich in zircon, ilmenite and monazite. With the improvements in mineral processing and new markets emerging for this material the project represents a good opportunity for Iluka to monetise a historic stockpile and reduce ongoing rehabilitation obligations.

Engagement with stakeholders and government has commenced and we will provide further updates in due course.

With that I will now open up the lines for questions.

Operator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. If you would like to ask questions on the phone pleases press star-one and wait for your name to be announced. If you would like to cancel your request you can also press the pound or hash key.

Our first question comes from the line of Rahul Anand from Morgan Stanley. Please ask your question.

Rahul Anand: (Morgan Stanley, Analyst) Hi Tom and team, thanks for the opportunity. Look, the first question I have is relating to synthetic rutile pricing going forward. I understand the previous tonnages were locked in, in terms of prices and going forward you probably have some collars in place. But how should we think about the price you can achieve for synthetic rutile? That's the first one.

Second one is around pigment inventory levels. We here at Morgan Stanley have noticed that pigment inventory levels in the West are significantly higher than this time last year. Obviously in anticipation of a pickup in demand. I just wanted to get your views on how you are seeing that situation develop and how do you think about feedstocks in that regard? Thanks.

Tom O'Leary: Thanks Rahul. I think I'll pass both those questions to Matthew.

Matthew Blackwell: G'day Rahul, it's Matt here. Look, firstly on SR pricing, the contracts that we are selling into this year are essentially the same as what we had last year. As we announced at the time, those contracts that underpin Cataby more than 60% of those contracts have a floor price. None of them have a cap. Which makes them pretty unusual.

They're take or pay, and they run for another four years from the beginning of this year. So for the life of the kiln. One other mechanism, without going into all the details of them, is that they tend to track market. Maybe in a bit of a lagging fashion. So it gives us a great degree of clarity and insight as to where SR prices are heading.

But to be clear, there are no caps on these contracts. Absolute caps. So that's the first thing.

To your second question, pigment inventories. Look, the one that's most often reported is that of Kronos, which you might be referring to, and it's significantly higher. When Kronos calculate their day's sales it's a function of closing inventory divided by quarterly COGS for a particular quarter, then normalised to a daily basis.

So you have two influences. You have what you've actually got in stock, and how much you've sold in that particular quarter. So if you've had a slow quarter it doesn't actually give you the best line of sight to what the day sales actually are on a more normalised run rate. They're not seasonally adjusted. So I just point that out.

The second point I would make is that, in all of our discussions with our customers Q1 has either started in line or better than their expectations for pigment sales and demand. So in terms of the inventory we're not worried about it.

Rahul Anand: (Morgan Stanley, Analyst) Excellent. Just one follow-up there, Matt, with regards to synthetic rutile pricing. So in terms of I guess from next year onwards then, should we be thinking about a simple graded adjustment 90% by 95% for synthetic rutile? Or is there some other way to think about it in terms of achieved prices?

Matthew Blackwell: Sorry, say that again. I don't understand your question.

Rahul Anand: (Morgan Stanley, Analyst) So in terms of the pricing from next year, once you come out of the contracts. Should we...

Matthew Blackwell: Okay, sorry.

Rahul Anand: (Morgan Stanley, Analyst) …make any more grade adjustment for synthetic rutile? Or is there any further sort of pricing mechanism to take into account?

Matthew Blackwell: No, sorry. Look, perhaps I wasn't clear. These contracts run for another four years. So we don't come out of these contracts. These pricing mechanisms and the contracts that we have in place - the take or pay, no caps and collars - are the same mechanisms next year and the year after and the year after that as they are now.

Rahul Anand: (Morgan Stanley, Analyst) Oh, okay.

Matthew Blackwell: Sorry, to your point, when you talk about a collar, caps and collars. I guess if you call a floor price a collar, protecting the downside. But we don't have any upside constraints.

Rahul Anand: (Morgan Stanley, Analyst) Understood. So it's more of a put option. Okay, thanks for that.

Tom O'Leary: Yes, sorry Rahul. Just to clarify, it's not really a put option. It's we've got take or pay contracts in play for 85% of the offtake for the Cataby ilmenite. They extend, as Matt said, for a further five years. Then we've got an option to extend one of those contracts, which would be in the vicinity of 60% of kiln capacity, for a further four years. Effectively the second kiln campaign.

The pricing under those synthetic rutile contracts, offtake contracts, are, as Matt said, subject to floors which increase annually with CPI. They're not subject to caps. So we'll get market price for that synthetic rutile, subject to that floor.

Rahul Anand: (Morgan Stanley, Analyst) Understood. Thanks very much for that.

Tom O'Leary: No worries.

Operator: Thank you for the questions. The next question comes from the line of Paul Young from Goldman Sachs. Please go ahead.

Paul Young: (Goldman Sachs, Analyst) Yes, good morning Tom and team. First question is on zircon, only mentioned that first quarter sales of 66,000 tonnes are in line with expectations and remain in line with historical averages. But just noticing that last, first quarter of '18 sales were 90,000 tonnes. So wondering if you could just explain the difference there?

Secondly, interesting to know your view of underlying demand appears to be stable, and what you expect growth, if any, for global zircon demand this year. Considering that you are going to sell 40,000 tonnes less ZIC as a base case to it appears balance the market. Thanks.

Matthew Blackwell: Yes, Paul, it's Matt here. Good questions, two points I would make. First of all historical averages - one period doesn't make a historical average. If we look back over the last seven/eight years the 66,000 tonnes is higher than four of those periods and less than three of those periods. So that's why we talk about it in line with historical averages.

So that's to your first question, and it was in line with our expectations. We've been saying since July last year that we expected the fourth quarter to be slightly slow and the first quarter of this year to be slow as well. That's how it's panned out.

To your second question about demand, in terms of growth this year demand is probably going to be stable. But what we saw last year was probably a bit of inventory rebuilding in the first half of the year as well as underlying demand. In the second half of the year as people were running pretty lean inventories.

How that's going to play out in the overall demand this year, I don't think anyone's expecting demand to be significantly greater. But we do expect the year to be between supply and demand in balance.

Paul Young: (Goldman Sachs, Analyst) All right, so just elaborate further. So on demand side you're expecting basically no growth globally in 2019 as a base case then?

Matthew Blackwell: I think that the underlying demand will remain stable and there will be growth in sectors. How that plays out in the overall top line is probably more to be stable this year than last year.

Paul Young: (Goldman Sachs, Analyst) All right, Matt. Also are you seeing any signs of substitution at current prices? Also any change in customer trends in China, perhaps away from tiles?

Matthew Blackwell: Oh, look, the first question, there is no financial or technical reason at today's zircon price why people would substitute away from zircon to alternatives such as aluminium. That's the first point I would make.

Secondly, people substituting away from ceramic tiles in China, no. Pretty much every building when I was there last week had tiles still. I think they will continue to use tiles. What we are seeing actually globally is an increase in the use of tiles in markets that were previously very dominated by carpet and wood, such as North America where consumption of tiles is growing quite rapidly.

Paul Young: (Goldman Sachs, Analyst) Okay, thanks Matt. A question for Tom. So Sierra Leone, some progress it seems at Lanti, Tom, which is encouraging. Just noting your full year guidance of 150,000 tonnes, the fact it did 29,000 tonnes in the first quarter implies that you'll be running at 160,000 tonnes per annum for the last three quarters.

Just interested that without a doubt that's second half weighted because that's when the dry mine expansions kick in. Just wondering what's your planned exit rate for the fourth quarter please?

Tom O'Leary: Oh look, it's probably too early to be giving that sort of information. I don't think we're sort of preparing victory yet. But I think you've picked up well that we're very much encouraged by what's going on at the moment. I was in Sierra Leone just last week and there's a level of confidence associated with the team having experienced much better rates of production at the in-pit mining unit in particular.

So look, I think we're positive about the full year in Sierra Leone. But as I said earlier, the focus is now on increasing run times. But we'll keep updating with progress with quarterlies and at the half.

Paul Young: (Goldman Sachs, Analyst) Yes, last question Tom, just on head grade. Do you expect head grade to stay around the 3% for the remainder of the year? Or is that something that is too early to tell?

Tom O'Leary: Yes, I think that's probably a fair assumption to continue with.

Paul Young: (Goldman Sachs, Analyst) Okay, great. All right, thanks very much, I will pass that on.

Operator: Next question comes from the line of Jack Gabb from Merrill Lynch. Please go ahead.

Jack Gabb: (Merrill Lynch, Analyst) Hi Tom and team. Just two quick questions from me. Firstly just on sticking to zircon, how quickly do you anticipate the shortfall in zircon sales in Q1 to be reversed? So should we expect a similar sort of shortfall in Q2, or can you reverse quite quickly?

The second question is, just given the strength of the TiO2 market at the moment have you advanced plans for the restart of the second SR kiln? Thanks.

Tom O'Leary: Yes, I'll get Matt to take that, thanks.

Matthew Blackwell: Jack, Matt Blackwell here. So look, in terms of the reversal if you like of the zircon, we expect that the zircon demand to, or buying to increase over the first half. That's all that I'm prepared to say on that. I'm not going to give a guidance figure on sales for a quarter.

But we have given guidance so far on production year. We've said sales will be broadening in line with production and we're sticking to that. That's the first point.

On the second point in terms of TiO2, yes, we have continued to progress our studies and efforts around the restart of SR1. Obviously it hasn’t gone to an investment decision yet because we would have announced it. But we continue to be encouraged by what we're seeing in the market and continue to work on that project.

Jack Gabb: (Merrill Lynch, Analyst) Great, thanks very much.

Operator: Thank you for the questions. Our next question comes from the line of Hayden Bairstow from Macquarie. Please go ahead.

Hayden Bairstow: (Macquarie, Analyst) Yes, thanks guys. Just a couple of quick ones. On the TiO2 market, is this SR1 restart sort of your only volume option, or can you sell more ilmenite? Or is there some opportunity if we do get a much tighter market second half that you’ve got options there to lift? Obviously with Cataby going is there something you can do there in terms of ramping that up a little bit harder? Or does it all really rely on what you can do with SR1?

Just on the market itself, are you basically fully price contracted first half across the different products? Hence it's just a second half story on pricing? Thanks.

Tom O'Leary: I'll hand over to Matt for the pricing question Hayden. But in terms of responding to the demand for TiO2 feedstock, you talked about whether we can ramp Cataby up harder. We’re just ramping it up at the moment so probably a bit early to be pushing things too hard.

But we've said that it's the high quality feed, the Cataby feed, for our SR2 kiln. That's come back earlier than planned. So there's a possibility that we could produce a little bit more synthetic rutile than planned. So we'll see how that goes.

In Sierra Rutile obviously we've guided that amount and I've already given some commentary about whether we might - how we might fare there this year. But I think that's largely it.

But Matthew, do you want to talk a little bit about pricing?

Matthew Blackwell: Yes, look Hayden, on SR we're fully committed. In the first half that's a combination of contracts and some smaller spot sales that we've done. But you should assume that they reflect pricing of the day.

On rutile and high grade more generally I would refer you to the quarterly where we've just said that physically we’re unable to satisfy all the requests for feedstock. So you can read from that that we've sold everything that we're going to produce in the first half.

In terms of the pricing of that material any, given that we're now in April and customers would already have wanted to secure their produce for April, May and June, we would have factored in where we think the market is today.

Hayden Bairstow: (Macquarie, Analyst) Okay, terrific. Thanks for that.

Operator: Thank you for the questions. Next question comes from the line Peter O'Connor from Shaw and Partners. Please ask your question.

Peter O'Connor: (Shaw and Partners, Analyst) Good morning Tom, two questions. SR1, the studies you were talking about the timeline, have you mapped out or could you map out again the indicative of timeline of the studies, approvals, development, contracts et cetera that were taken?

Secondly, Matt, I love your comment about you said, you have absolute clarity to where SR prices are headed. I think I've got that right. Where are they headed?

Tom O'Leary: Okay, I'll leave Matt a moment or two to work up his answer to that question. But in the interim, we haven't mapped out a timeline for SR1 restart. There's - it's a matter of a number of things. It's looking at the cost and process to re-establish SR1 to operating condition. But that's probably a year.

We also need to bed down ilmenite supply for that kiln. That's probably the one that’s taking some time. So once we have clarity on that we'll come back to the market and disclose what you're after there.

Peter O'Connor: (Shaw and Partners, Analyst) Tom, could I follow up?

Tom O'Leary: Yes.

Peter O'Connor: (Shaw and Partners, Analyst) How much flex is there geographically in terms of feed? Has freight become a constraint in that equation? Or is that not a big enough component of the cost input that drives your decision?

Tom O'Leary: Well, from time to time it would be. But not at the moment. So I don’t think that's a driver.

Peter O'Connor: (Shaw and Partners, Analyst) Thanks.

Tom O'Leary: Right, Matthew.

Matthew Blackwell: So Peter, absolute clarity did I say? Well, I meant certainly clear, and they’ll be different to where we are today. The market momentum would suggest that they're going to be in the right direction. I won’t give forward looking statements from an anti-trust perspective.

But what I can say is that, we have really good visibility because of how the mechanisms work as to where those prices will be in the second half. I can't tell you exactly what they are, but they will move with the market. If you get a view of where the market is moving and sort of how that's percentage-wise changing halves-on-halves and things like that you can start to think where the prices might head.

Peter O'Connor: (Shaw and Partners, Analyst) How does the market respond to the tightness with regards to the discount relative to natural rutile? Is that something that moves and flexes over time?

Matthew Blackwell: Yes, it does. Certainly the relative, you’ve probably heard us talk in the past, we sell our TiO_2 products on a relative economic value basis. So that takes into account not only the tightness and supply in the market and availability of other materials, but where those materials are sold as well. So yes, we consider all those things as we price Peter.

Look, I'd like to talk to you more about it but I just can't because of the type of contracts we have and to be fair to our customers.

Peter O'Connor: (Shaw and Partners, Analyst) Okay, thanks Matt, thanks Tom.

Matthew Blackwell: No worries.

Tom O'Leary: Thanks Peter.

Operator: Thank you for the questions. We have questions from the line of Glyn Lawcock from UBS. Please go ahead.

Glyn Lawcock: (UBS, Analyst) Good morning Tom. Look, just on the Eneabba tailings project, I noted the study is only three months away. Just could you put some more meat around that a little bit? Just where are you thinking of processing it, the routes, sort of the size of the prize that come out of this project? Which is sort of, as you said, just come onto the drawing board, this report.

Then secondly, just a little bit more on SR pricing. I'm just more interested in, so if you think back and Matt talked a little bit about where inventory has been historically average, or sales sorry for a quarter. But just wondering what's the historical differential for SR to rutile as things normalise over time? Just curious about the historical differential, thanks.

Tom O'Leary: Okay, Glyn, I'll take the Eneabba project and I'll pass over to Matt for the second question. Look, we've just started disclosing it, but we have actually been working on it for a little while. It is still in feasibility stage. What I would say is that in terms of the size of the prize, we disclosed back in 2016 with our Resource and Reserve Statement that we had a resource of nearly 500,000 tonnes, which is not just monazite, but includes ilmenite and zircon.

We have continued to produce since then. So it's a reasonably significant deposit in its own right. The capital associated with processing it will depend on the route we take in terms of how far we upgrade it. But it could be mobilised for a relatively small amount of capital. Then upgraded later to attract a higher price for the offtake.

But we will disclose a bit more detail about that hopefully in the third quarter when we have concluded that study.

Glyn Lawcock: (UBS, Analyst) So Tom, is it a kiln? Does it need the kiln at all?

Tom O'Leary: Oh, no. No, not for the level of upgrading that we are contemplating there.

Glyn Lawcock: (UBS, Analyst) Okay, thanks. The SR differential, just quickly.

Matthew Blackwell: Yes, Glyn, it's Matt. Look, the differential depends on who is selling the rutile at different times, the shortness in the market. As I said, I can't talk about going forward because of the contractual requirements. But I guess I just have to point you to, say, TZMI's trade stats.

If you looked back over the last five years you can draw a bit of a view from that where SR has been trading compared to rutile. Get a bit of a feel for that band of what the ratio is.

Glyn Lawcock: (UBS, Analyst) So Matt, can you get back to that then do you think?

Matthew Blackwell: What do you mean, can we get back to it?

Glyn Lawcock: (UBS, Analyst) The band, if I go back and look at that differential can you get back to what it used to be?

Matthew Blackwell: Well, will it revert to it? I think you'd find rutile on an REV basis is trading at a premium to most products in the market today. So SR to rutile over a period of time when things become, in the fullness of time, you would expect there to be some I guess averaging out. But at the moment there's a premium.

What I'm more concerned about is the premium that SR to, say, slag in my competitive products rather than to rutile.

Glyn Lawcock: (UBS, Analyst) All right, thanks.

Operator: Thank you for the questions. Once again if you would like to ask a question please press star-one and wait for your name to be announced. We have follow-up questions from Peter O'Connor from Shaw and Partners. Please go ahead.

Peter O'Connor: (Shaw and Partners, Analyst) Matt, some of us are not fortunate enough to have the luxury of sitting here and strolling through a TZMI publication. So I don't think I could send Glyn a question and get him to give me the details. So what should I think about if I could find a TZMI copy, what would that detail tell me over the last five years?

Matthew Blackwell: Oh Peter, that today the rutile price on an REV basis is probably higher than the traditional ratio. I'm not quite sure where the question is going, what are you…

Peter O'Connor: (Shaw and Partners, Analyst) I think we're all trying to get to the point of the relative pricing today versus what it's traded at for X-years, five years or whatever the date it was looked at. If we look at most commodities normalisation of commodity pricing. So where are we today, where has the trend been? We can all - we know the drivers today that you've talked about and then we can make a judgement going forward.

I know you're not giving us any forward commentary, that's fine. But we can make a judgement where we think that may go - high or low or normalised. But just where has it been?

Matthew Blackwell: Oh look, yes, I don't have the exact ratio in front of me so I don't want to quote the exact number. But what I could say is, that you would expect over time probably SR to catch up to rutile and getting closer to rutile than it is today if it was to normalise back to historical levels.

Peter O'Connor: (Shaw and Partners, Analyst) Okay, that's great. Thanks.

Operator: Thank you for the questions. We have no more questions from the line. I would like to hand the call back to the management for closing.

Tom O'Leary: Thank you for your time and participation today. Look forward to seeing you later in the year.

Operator: Thank you ladies and gentlemen, that does conclude the conference for today. Thank you for your participation, so you may now disconnect your lines.

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