TRONOX INC
Form 10-Q
May 08, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007
Commission file number 1-32669
TRONOX INCORPORATED
(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-2868245**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*

One Leadership Square, Suite 300
211 N. Robinson Ave, Oklahoma City, Oklahoma 73102
(Address of principal executive offices)
Registrant s telephone number, including area code: (405) 775-5000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (see definition of accelerated filer in Rule 12b-2 under the Exchange Act). (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of April 30, 2007, 18,562,402 shares of the company s Class A common stock and 22,889,431 shares of the company s Class B common stock were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

TRONOX INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share data)
(Unaudited)

	Three Months Ended March 31, 2007	2006
Net sales	$ 339.1	$ 338.8
Cost of goods sold	301.3	276.0
Gross margin	37.8	62.8
Selling, general and administrative expenses	35.6	38.3
Provision for environmental remediation and restoration, net of reimbursements	0.2	(20.5)
	2.0	45.0
Interest and debt expense	(12.3)	(12.0)
Other income, net	1.7	4.4
Income (loss) from continuing operations before income taxes	(8.6)	37.4
Income tax provision	(0.4)	(13.8)
Income (loss) from continuing operations	(9.0)	23.6
Loss from discontinued operations, net of income tax benefit of $0.2 and $1.8, respectively	(0.4)	(3.0)
Net income (loss)	$ (9.4)	$ 20.6
Income (loss) per common share:		
Basic		
Continuing operations	$ (0.22)	$ 0.58
Discontinued operations	(0.01)	(0.07)
Net income (loss)	$ (0.23)	$ 0.51
Diluted		
Continuing operations	$ (0.22)	$ 0.58
Discontinued operations	(0.01)	(0.08)
Net income (loss)	$ (0.23)	$ 0.50
Dividends declared per common share	$ 0.05	$ 0.05
Weighted average shares outstanding:		

Basic	40.6	40.4
Diluted	40.6	40.9

The accompanying notes are an integral part of these financial statements.

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TRONOX INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except share data)
(Unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 44.5	$ 76.6
Accounts receivable, net	331.5	325.6
Inventories, net	351.3	319.2
Prepaid and other assets	20.1	15.2
Income tax receivable	8.9	13.9
Deferred income taxes	35.0	43.6
Total current assets	791.3	794.1
Property, plant and equipment, net	856.6	864.6
Goodwill	11.6	11.5
Other long-term assets	153.5	153.2
Total assets	$ 1,813.0	$ 1,823.4
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 182.4	$ 183.6
Accrued liabilities	216.2	212.0
Long-term debt due within one year	14.7	14.7
Income taxes payable	4.4	1.6
Total current liabilities	417.7	411.9
Long-term liabilities:		
Deferred income taxes	16.6	33.6
Environmental remediation and/or restoration	120.1	128.6
Long-term debt	533.9	534.1
Other long-term liabilities	299.7	277.9
Total long-term liabilities	970.3	974.2
Commitments and contingencies (Notes 12 and 13)		
Stockholders equity		
Class A common stock, par value $0.01 100,000,000 shares authorized, 18,702,399 and 18,388,202 shares, respectively, issued and outstanding	0.2	0.2
Class B common stock, par value $0.01 100,000,000 shares authorized, 22,889,431 shares issued and outstanding	0.2	0.2

Capital in excess of par value	485.6	481.6
Accumulated deficit	(33.6)	(12.8)
Accumulated other comprehensive loss	(25.2)	(31.4)
Treasury stock, at cost 142,446 shares and 33,533 shares, respectively	(2.2)	(0.5)
Total stockholders equity	425.0	437.3
Total liabilities and stockholders equity	$ 1,813.0	$ 1,823.4

The accompanying notes are an integral part of these financial statements.

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TRONOX INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Three Months Ended March 31, 2007	2006
Cash flows from operating activities		
Net income (loss)	$ (9.4)	$ 20.6
Adjustments to reconcile net cash flows from operating activities		
Depreciation and amortization	27.9	24.5
Deferred income taxes	(3.8)	7.1
Provision for environmental remediation and restoration, net of reimbursements	1.7	(20.2)
Other noncash items affecting net income (loss)	8.6	15.5
Changes in assets and liabilities	(39.9)	(33.1)
Net cash flows from operating activities	(14.9)	14.4
Cash flows from investing activities		
Capital expenditures	(14.3)	(21.8)
Other investing activities		0.1
Net cash flows from investing activities	(14.3)	(21.7)
Cash flows from financing activities		
Stock option exercises	1.2	
Repayment of debt	(0.5)	(0.5)
Debt issuance costs	(0.3)	(1.2)
Dividends paid	(2.1)	
Net cash flows from financing activities	(1.7)	(1.7)
Effects of exchange rate changes on cash and cash equivalents	(1.2)	(2.7)
Net change in cash and cash equivalents	(32.1)	(11.7)
Cash and cash equivalents at beginning of period	76.6	69.0
Cash and cash equivalents at end of period	$ 44.5	$ 57.3

The accompanying notes are an integral part of these financial statements.

TRONOX INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. The Company

Tronox Incorporated (the company), a Delaware Corporation was formed on May 17, 2005, in preparation for the contribution and transfer by Kerr-McGee Corporation (Kerr-McGee) of certain entities, including those comprising substantially all of its chemical business (the Contribution). The company has one reportable segment representing the company s pigment business. The pigment segment primarily produces and markets titanium dioxide pigment (TiO_2) and has production facilities in the United States, Australia, Germany and The Netherlands. The pigment segment also includes heavy minerals production operated through our joint venture. The heavy minerals production is integrated with our Australian pigment plant, but also has third-party sales of minerals not utilized by the company s pigment operations. Electrolytic and other chemical products (which does not constitute a reportable segment) represents the company s other operations which are comprised of electrolytic manufacturing and marketing operations, all of which are located in the United States. The company has in the past operated or held businesses or properties, or currently holds properties, that do not relate to the current chemical business.

The terms Tronox or the company are used interchangeably in these condensed consolidated financial statements to refer to the consolidated group or to one or more of the companies that are part of the consolidated group.

Formation

The Contribution was completed in November 2005, along with the recapitalization of the company, whereby common stock held by Kerr-McGee converted into approximately 22.9 million shares of Class B common stock. An initial public offering (IPO) of Class A common stock was completed on November 28, 2005. Prior to the IPO, Tronox was a wholly-owned subsidiary of Kerr-McGee. Pursuant to the terms of the Master Separation Agreement dated November 28, 2005, among Kerr-McGee, Kerr-McGee Worldwide Corporation and the company (the MSA), the net proceeds from the IPO of $224.7 million were distributed to Kerr-McGee.

Following the IPO, approximately 43.3% of the total outstanding common stock of Tronox was held by the general public and 56.7% was held by Kerr-McGee. The holders of Class A common stock and Class B common stock have identical rights, except that holders of Class A common stock are entitled to one vote per share, while holders of Class B common stock are entitled to six votes per share on all matters to be voted on by stockholders.

On March 8, 2006, Kerr-McGee s Board of Directors declared a dividend of the company s Class B common stock owned by Kerr-McGee to its stockholders (the Distribution). The Distribution was completed on March 30, 2006, resulting in Kerr-McGee having no ownership or voting interest in the company.

2. Basis of Presentation and Accounting Policies

These statements should be read in conjunction with the audited consolidated and combined financial statements and the related notes which are included in the company s annual report on form 10-K for the year ended December 31, 2006. The interim condensed consolidated financial information furnished herein is unaudited. The information reflects all adjustments (which include only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods included in the report.

Certain prior-year amounts have been reclassified to conform with the current-year presentation. Sales rebates, previously presented with accounts payable, are now presented with accrued liabilities in the company s Condensed Consolidated Balance Sheets. Additionally, presentation of the three-month period ending March 31, 2006, in the company s Condensed Consolidated Statements of Operations include reclassification of $2.6 million related to certain selling, general and administrative expenses for which the Company is reimbursed and commissions on sales of product which had previously been recorded as rebates. As a result of the reclassification, prior-period revenues and selling, general and administrative expenses are $2.6 million higher than previously reported. The change had no impact on income from continuing operations or net income.

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes (SFAS 109). The company adopted FIN 48 as of January 1, 2007. FIN 48 clarifies the application of SFAS 109 by defining criteria that an uncertain tax position must meet in order to be recognized in an enterprise s financial statements. FIN 48 also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The guidance requires application through recognition of a cumulative effect adjustment to opening retained earnings in the period of adoption, with no charge to current earnings for prior periods. The results for prior periods have not been restated. As a result of the adoption of FIN 48, the company recognized a $9.3 million charge to the January 1, 2007, balance of retained earnings. The total amount of unrecognized tax positions at January 1, 2007, was $60.7 million. Adoption of FIN 48 did not have a material impact on the company s loss from continuing operations or net loss for the three months ended March 31, 2007.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The company is reviewing SFAS 157 to determine the impact on the company s financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an Amendment of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 159). The company is currently assessing whether or not the provisions of SFAS 159 will be implemented and what the financial statement impact would be, if any. If the company chooses to implement SFAS 159, the effective date would be January 1, 2008.

3. Statement of Operations Data

The components of other income, net consist of:

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
	(In millions)	
Net foreign currency transaction gain (loss)	$ (0.3)	$ 4.3
Equity in net earnings of equity method investees	0.7	
Interest income	0.8	0.7
Other income (expense)	0.5	(0.6)
Total	$ 1.7	$ 4.4

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The following table sets forth the computation of basic and diluted earnings per share from continuing operations for the periods indicated. For the three months ended March 31, 2007, all potentially issuable shares were antidilutive.

	Three Months Ended March 31, 2007			Three Months Ended March 31, 2006		
	Loss from Continuing Operations	Shares	Per-share Loss	Income from Continuing Operations	Shares	Per-share Income
	(In millions, except per share amounts)					
Basic earnings per share	$ (9.0)	40.6	$ (0.22)	$ 23.6	40.4	$ 0.58
Effect of dilutive securities:						
Restricted stock and stock options					0.5	
Diluted earnings per share	$ (9.0)	40.6	$ (0.22)	$ 23.6	40.9	$ 0.58

Stock options outstanding of approximately 457,000 at March 31, 2007, were out of the money, thus, antidilutive. The average exercise price of these antidilutive options was $15.19. Since the company incurred a loss from continuing operations for the three months ended March 31, 2007, no dilution of the loss per share would result from an additional 1.9 million potentially dilutive shares outstanding at March 31, 2007.

4. Balance Sheet Data

Accounts receivable, net of allowance for doubtful accounts, consist of the following:

	March 31, 2007	December 31, 2006
	(In millions)	
Accounts receivable trade	$ 285.0	$ 281.1
Receivable from Kerr-McGee	17.5	17.5
Receivable from the U.S. Department of Energy	11.5	11.0
Receivable from insurers	7.5	7.4
Other	23.1	21.3
Accounts receivable, gross	344.6	338.3
Allowance for doubtful accounts	(13.1)	(12.7)
Accounts receivable, net	$ 331.5	$ 325.6

Inventories, net of allowance for obsolete inventories and supplies, consist of the following:

	March 31, 2007	December 31, 2006
	(In millions)	
Raw materials	$ 89.6	$ 67.5
Work-in-progress	14.3	13.4
Finished goods	183.8	174.8
Materials and supplies	71.1	71.4

Inventories, gross	358.8	327.1
Allowance for obsolete inventories and supplies	(7.5)	(7.9)
Inventories, net	$ 351.3	$ 319.2

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Property, plant and equipment, net, consists of the following:

	March 31, 2007	December 31, 2006
	(In millions)	
Land	$ 72.2	$ 72.2
Buildings	160.0	159.4
Machinery and equipment	1,775.0	1,795.6
Other	111.1	103.7
Property, plant and equipment, gross	2,118.3	2,130.9
Less accumulated depreciation	(1,261.7)	(1,266.3)
Property, plant and equipment, net	$ 856.6	$ 864.6

Other long-term assets consist of the following:

	March 31, 2007	December 31, 2006
	(In millions)	
Receivable from the U.S. Department of Energy	$ 16.5	$ 15.9
Investments in equity method investees	21.8	21.1
Receivables from insurers	17.6	19.6
Debt issuance costs, net	10.7	11.0
Prepaid pension cost	26.2	25.3
Intangible Asset Proprietary Technology(1)	52.9	52.6
Other	7.8	7.7
Total other long-term assets	$ 153.5	$ 153.2

(1) Associated with the company s reportable pigment segment.

Accrued liabilities consist of the following:

	March 31, 2007	December 31, 2006
	(In millions)	
Employee-related costs and benefits	$ 40.7	$ 37.2
Reserves for environmental remediation and restoration current portion	101.0	95.3
Sales rebates	17.1	24.7
Other	57.4	54.8

Total accrued liabilities	$ 216.2	$ 212.0

Other long-term liabilities consist of the following:

	March 31, 2007	December 31, 2006
	(In millions)	
Reserve for uncertain tax positions	$ 62.3	$
Reserve for income taxes payable		45.5
Pension and postretirement obligations	169.1	167.5
Asset retirement obligations	24.6	23.6
Reserve for workers compensation and general liability claims	17.5	18.8
Other	26.2	22.5
Total other long-term liabilities	$ 299.7	$ 277.9

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5. Summarized Combined Financial Information of Affiliates

The company has investments in Basic Management, Inc. and Subsidiaries (a corporation in which the company has a 31% interest, whose combined financial statements include The LandWell Company, L.P., a limited partnership in which the company has a 29% direct interest). The company recognized $0.7 million and nil of equity in net earnings of equity method investees for the three months ended March 31, 2007 and 2006, respectively. Summarized unaudited income statement information of the significant investees is as follows:

	Three Months Ended March 31,	
	2007	2006
	(In millions)	
Gross revenues	$7.9	$ 1.4
Gross profit	5.9	0.6
Income (loss) before taxes	4.2	(1.2)
Net income (loss)	3.7	(0.8)

6. Long-Term Debt

The company is required, under the terms of the credit agreement, to remit a certain percentage of excess cash flow (ECF Percentage, as defined in the credit agreement). As a result, in addition to the normal quarterly installments, the first such annual mandatory payment, in the amount of $11.1 million, was paid in April 2007, based on the ECF Percentage for the fiscal year 2006.

In March 2007, the company requested and obtained approval for an amendment to the financial covenants in the credit agreement. The amendment maintains the original Total Leverage Ratio and the Interest Coverage Ratio (both as defined in the credit agreement) at 3.75:1 and 2:1, respectively, through December 31, 2007. For fiscal year 2008, the Total Leverage Ratio must be no more than 3.50:1 and the Interest Coverage Ratio must be at least 2.5:1 in the first two quarters and 3.00:1 in the last two quarters. The amendment did not modify the limit on capital expenditures, which is $130 million in 2007 and 2008.

7. Comprehensive Income (Loss)

Comprehensive income (loss), net of taxes, consists of the following:

	Three Months Ended March 31,	
	2007	2006
	(In millions)	
Net income (loss)	$ (9.4)	$ 20.6
After tax changes in:		
Foreign currency translation adjustments	3.3	6.0
Cash flow hedge activity:		
Unrealized gain (loss), net of taxes of $(0.6) and $0.3	1.0	(0.5)
Reclassification adjustments, net of taxes of $(0.4) and $(0.3)	0.8	0.2
Benefit plan activity:		
Amortization of net actuarial loss, net of taxes of $(0.4)	0.9	
Amortization of net prior service cost, net of taxes of $(0.2)	0.2	
Minimum pension liability adjustment		(1.1)
Total comprehensive income (loss)	$ (3.2)	$ 25.2

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8. Income Taxes

The reconciliation of the federal statutory rate to the effective income tax rate applicable to income (loss) from continuing operations is as follows:

	Three Months Ended March 31,	
	2007	2006
U.S. statutory tax rate	35.0%	35.0%
Increases (decreases) resulting from		
Taxation of foreign operations	(37.6)	2.0
State income taxes	1.6	1.0
Interest on foreign tax contingency	(0.7)	0.6
FIN 48 adjustment	(5.7)	
Other net	2.8	(1.7)
Effective income tax rate	(4.6)%	36.9%

The company adopted the provisions of FIN 48 as of January 1, 2007. As a result of the adoption of FIN 48, the company recognized a $9.3 million charge to the January 1, 2007, balance of retained earnings. The gross amount of unrecognized tax positions at January 1, 2007, was $60.7 million. If recognized, the benefit associated with approximately $54.5 million of our reserve for unrecognized tax benefits would affect the effective income tax rate.

The company anticipates a decrease in the unrecognized tax benefit for tax positions where the statute will lapse during the next twelve months. These unrecognized tax benefits relate primarily to transactions involving the effects of foreign currency translation and transfer pricing. The company estimates the change could be a net amount of approximately $2.0 million.

The company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the three months ended March 31, 2007, the company recognized approximately $0.7 million in gross interest, including the effect of foreign exchange translation. As of January 1, 2007, the company had approximately $7.9 million accrued for the gross payment of interest and penalties.

The Internal Revenue Service has completed its examination of the company s U.S. Federal income tax returns for all years through 2002 and is currently conducting an examination of the years 2003 through 2005. The years through 1998 have been closed with the exception of issues for which a refund claim has been filed. A German audit is being conducted for the years 1998 through 2001. No periods have closed with respect to Australia, Germany, Switzerland or The Netherlands (periods subsequent to the acquisition in 2000). The company believes that it has made adequate provision for income taxes