Iluka Resources

Extracts from Recent US Paint Manufacturer Calls

Direct extracts on references to TiO_2 and raw material pricing increases (names removed)

Sherwin-Williams Conference Call August 2011

Gross margin decreased 200 basis points to 43.4% of sales from 45.4% in the second quarter last year.

The increase in sales for the segment was due primarily to selling prices increases implemented during the past year and improved domestic architectural paint sales to DIY customers, residential repaint contractors and property management contractors.

The one line on our second quarter P&L that didn't go quite as we expected was gross profit. A portion of the 200 basis point gross margin contraction we recorded was due to dilution from acquisitions, which was no surprise. But the frequency and magnitude of raw material cost increases in the quarter, particularly in Titanium dioxide, continued to outpace our ability to recoup in the short term.

In our last earnings call, I mentioned the impact of higher raw material costs would likely get worse before they got better. At that time, we predicted that the coatings industry would experience averaged annualized year-over-year raw material price inflation in the mid-teens for all of 2011. Over the past three months, we have revised our internal raw material costs projections three times. We now believe a year-over-year raw material increase in the high teens to the low 20% range is more realistic.

As we have discussed in the past, when raw material costs rise, we have a duty to our customers to push back on our suppliers to avoid or postpone these increases. In failing that, to focus internally on ways to offset higher raw material costs. But the rate of increases we have seen over the past six months have overwhelmed these efforts and left us with few options.

In early June, again, we announced additional price increases in the high single-digit range across most of our product lines. Although we are in the early stages of implementing these increases, they should help to offset the raw material cost increases we incurred in the second quarter. Not surprisingly, price utilization in our Paint Stores Group is running ahead of all other segments.

<Q>: Okay. And then just one follow-up. I know typically it seems like demand for coatings is relatively inelastic with regard to price. But as you indicated in your opening remarks, it seems like we are in an unprecedented environment at this point, in terms of how much you have to put through on price increases. So are you seeing any push back at all that would say that maybe we will see a little bit more elasticity of demand around price? Or is it still going to be inelastic but your customers are just kind of aggravated by it?
<A >: John, this is Sean Hennessy. And we watch that question carefully. We continue to look at how to mix the products and so forth. And the increase of raw materials is, as you said, unprecedented. But we still believe over the long term eventually we are going to be able to recover these raw materials in the marketplace – recover our gross margin.

<Q >: If you look at the suppliers of TiO_2, and I know DuPont has announced another price hike. And I don't know when that starts to flow through. But it is their – I know you all look at China a lot. Is there a way to move the Chinese manufacturers from low-grade to high-grade? And if so how long does that process take, et cetera?

<A >: Stephen, we have a lot of work being done right now in our industry and certainly here at Sherwin on that very subject. There a number of what to heretofore have been lesser grade titanium suppliers that are rapidly working to get their quality levels up. We have quite a bit of that material at various stages of testing and both in laboratories as well as in manufacturing facilities. And time will tell. China is one of the locations, Eastern Europe is other. And I think at price levels where they are today for titanium, you're seeing far more interest and capacity coming on stream and development happening.
<Q>: Is this more, Chris, a 2012-type event?
<A >: I think you starting to see it trickle into our products right now. It's just not going to be at substantial enough volume to make much of a difference in offsetting the increases that we've been talking about now up into the low 20% range.
<A>: Over the last three price increases consolidated?
<Q >: Yeah. Something -- if you combine all those.
<A >: Yes?
<Q >: How much of that you think actually stuck? I know it takes time for you to get through all the pricing?
<A >: Yeah, when we take a look at it – again, in April one of those did fall off. June we did put another price increase out there. So it's a little bit of a timing and differential. But over the long-term we still believe we are going to get between 70 and 75% on these. Last December, we're two quarters into that. And when we look at that, we usually, after about two quarters, we're in the 55% range. And we are right there. And eventually we are going to get all 75% of these.
<Q >: Forgive me. And then lastly, it sounds like the reason why you are a little bit more pessimistic about your earnings outlook this year has to do with the inflation and raw material costs? When do you think your prices catch up to your raw materials?
<A >: Yeah. I think it's absolutely raw materials, Jeff. We're feeling very good about most of the segments in the company and the way that they are headed, and we think we're coming into a better second half on volume. We've been very clear with the investment community about the unabated run-up in these raw material costs. We took pricing again in June to the market, and as Sean has commented, this price increase will go in, as the others have. As you know, it take us the better part of 9 to 12 months to be fully implemented, and at full implementation, we'll have about 75% of it in. So if all raw material cost increases stopped today, we would be somewhere into the first half of next year to have our pricing catch up.

Valpasar's Third Quarter Conference Call- August 2011

Market conditions were somewhat difficult in the quarter, with both a challenging demand environment and higher raw material costs, so we were pleased that we delivered solid results, with double-digit increases in both sales and earnings per share. We maintained our operational discipline, and we prudently managed the things that we can control. We're making a good progress in restoring our operating margins through pricing and improved productivity. Year-to-date, we've secured almost 10% in pricing globally and our operating margin was up 80 basis points sequentially from the second quarter.

Raw material costs continued their upward trend during the quarter and we now expect an increase of about 20% for the year, so we still have work to do. We're in the process of working with our suppliers and our customers to address cost price and remain confident that we'll restore our operating margins in 2012.

<Q >: Is it fair to say that you're more encouraged with your Paint price increases and less encouraged with your recovery of raw material costs in Coatings?
<A >: Not really, Jeff. I think in both segments, we're – we've made roughly equivalent progress. We're about – in both segments, we're about 80%, maybe a little bit more than 80%, of the way to recovering the cost price.
<Q >: And is it the case that you expect to be closer to 100% in the fourth quarter or less than 80% in the fourth quarter?
<A >: We won't be 100% in the fourth quarter, but we're already more than 80% and I would expect to continue to make further progress in the fourth quarter toward 100%.

<Q >: What have your bonus accruals been like year-over-
In terms of Huarun (sic) [China], I mentioned that we opened 100 stores, more than 100 stores in the quarter and that's good. We have seen some modest slowing of our sales in China. We still delivered mid-single-digits growth in Huarun, which was a little bit below what we did in the third quarter of last year. I think there's a little bit of uncertainty among our distributors about what happened in the property market, but the fact that our distributors were willing to invest their money in opening 100 new stores tells me that their long-term – medium to long-term view of the market is it remains strong.

Lori just pointed out to me that I said mid-single-digits for Huarun growth. It was actually mid-teens.

<Q -: Just on TiO_2, the latest round of price increases that should hit in the fall, what's your ability to push back on those price increases given some perhaps less robust volume growth that we're looking at.
<A : Yeah, we pushed back on all of them, David. And we had – to-date we haven't been successful, quite frankly. So, I think this is a story that will play out over the next couple of quarters, maybe the next year or, so. But I believe that there's a supply and demand imbalance in the world, and they have some pricing power at the moment. And we're dealing with that in other ways in terms of qualifying alternative materials and we've talked in previous calls about a number of things that we have to do to offset that. But just in terms of price, I think we're probably going to end up taking some pricing.

<Q : Okay, great. And then, with regard to the TiO_2 raw material hikes, is there anything that you've been able to do or expect to be able to do to improve or change your contract structure with some of your larger customers so that you may – it may facilitate maybe an easier way of getting through price increases to offset some of these raw materials?
<A -: If there's any positive about the TiO_2 story it's this: is that there's an awareness throughout the supply chain that there is significant TiO_2 inflation. So, we don't need to educate our customers any longer about our need for pricing to deal with the TiO_2 inflation. They're all very aware of it. But just in terms of contract pricing, I don't think we've changed. We haven't changed our contract structure to accommodate a specific raw material.