THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NEMAKA.MX - Q2 2018 Nemak SAB De CV Earnings Call

EVENT DATE/TIME: JULY 19, 2018 / 3:30PM GMT

CORPORATE PARTICIPANTS

Adrian Althoff *Nemak, S. A. B. de C. V. - IR Officer*

Alberto Sada Medina *Nemak, S. A. B. de C. V. - CFO*

Armando Tamez Martínez *Nemak, S. A. B. de C. V. - CEO*

CONFERENCE CALL PARTICIPANTS

Alejandro Azar Wabi *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

Augusto Akihito Ensiki *HSBC, Research Division - Latin America Analyst*

Gilberto Garcia *Barclays Bank PLC, Research Division - Assistant VP & Equity Research Analyst*

Jean Baptiste Bruny *BBVA Corporate and Investment Bank, Research Division - Research Analyst*

Juan Tavarez *Citigroup Inc, Research Division - Director and Analyst*

Luis Miranda Valenzuela *Santander Investment Securities Inc., Research Division - Head of Food and Beverage*

Mauricio Serna Vega *UBS Investment Bank, Research Division - Analyst*

Travis Pascavis

Vanessa Quiroga *Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil*

PRESENTATION

Operator

Good morning, everyone, and welcome to Nemak's Second Quarter 2018 Earnings Call.

Armando Tamez, Nemak's CEO; Alberto Sada, CFO; and Adrian Althoff, Investor Relations Officer, are here this morning to discuss the company's performance and answer any questions that you may have. As a reminder, today's conference is being recorded and will be available on the company's Investor Relations website.

I will now turn the call over to Adrian Althoff.

Adrian Althoff *- Nemak, S. A. B. de C. V. - IR Officer*

Thank you, operator. Good morning, and welcome, everyone. We very much appreciate your participation. Armando Tamez, our CEO, will lead off today's call by providing an overview of our business and financial highlights. Alberto Sada, our CFO, will then discuss key industry trends and our second quarter financial results in more detail.

Afterwards, we will open up for a Q&A session.

Before we get started, let me remind you, the information discussed on today's call may include forward-looking statements regarding the company's future financial performance and prospects, which are subject to risks and uncertainties. Actual results may differ materially, and the company cautions not to place undue reliance on these forward-looking statements.

Nemak undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

I will now turn the call over to Armando Tamez.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Thank you, Adrian. Hello, everyone, and welcome to Nemak's Second Quarter 2018 Conference Call. We posted good result this quarter on the back of a richer sales mix and operational improvements, but at the same time continue to lay the groundwork profitable growth in our new structural and electric vehicle component business.

Consolidated volumes were up 2.3%, that's a better performance among the top 3 automakers in North America, more than concentrated for lower sales for diesel applications Europe. In turn, higher volume, plus a combination of the exchange rate effect and higher aluminum prices supported 6.3% growth in revenues.

Moving onto EBITDA. Improved volumes and operational performance were key factors. Additionally, we benefited from favorable exchange rate as well as less adverse aluminum price plans.

Adjusting for $80 million in nonrecurring income we reported in the second quarter of 2017, EBITDA finish up 10% year-over-year.

We had a positive quarter in our operations, bringing new products across our main business line to see this production, while at the same time making continuous progress with manufacturing and labor cost-reduction initiatives.

The main bright spots were Europe and North America, where we successfully capitalized on a more favorable mix of higher value-added service including cylinder heads, engine blocks, and structural and electric vehicle component.

As we mentioned in the earnings release, we also completed customer discussions on new pricing adjustments that will protect us against major operations in aluminum markets.

The recent divergence between primary and secondary price differences in North America, fueled in part by a speculation around potential transactions. This divergence has been creating a mismatch between the project and sales prices associated with a portion of our production in the region, resulting in a headwind for Nemak.

This problem is now behind us. With the pricing adjustments we have put in place, we expect that this divergence will have no effect on our results going forward.

I will now like to point to our structural and electric vehicle component business, where we continue to build on existing resources and know-how to capture new opportunities.

As we have mentioned in previous conference calls, our technology portfolio represents a key advantage in working with customers in this segment, enabling us to offer tailor-made solutions as opposed to depending on a single approach.

Additionally, our engineering and design capabilities, including casting simulation, in-house 3D printing and production-like prototypes among others, help us drive value in rapid response services from the early concept phase, reducing cost and expediting development and production time lines for our customers.

We made good progress in the quarter in these results, leveraging our expertise in casting and machining to secure 2 new projects in Europe, involving highly integrated e-motor housings, one. A contract to supply battery electric applications for new premium vehicle line starting in 2020. And Europe, an exclusive collaboration agreement with a new Tier 1 customer.

I would also like to highlight recent progress in battery housings, and all of those lines where we see exceptional potential for tapping into our core competencies.

During the quarter, I am pleased to share that we started to launch our first program to produce battery housings in North America, through which we will be supplying hybrid vehicles of a premium Europe OEM.

Our ability to provide advanced design and casting cooling solutions, which are critical to crash resistance and battery performance, respectively, have been key to the traction we have gained so far in battery housings.

Our sales backlog to-date, in this component, is worth a total of approximately $80 million in annual revenues, or 20% of the estimated total market employing hybrid vehicles in Europe and North America by 2020.

Summarizing, our sales and marketing activity from the quarter, we won new contracts worth approximately 1/4 of $50 million in annual revenues, one quarter of which represented incremental business.

I would like to conclude by touching on a great honor we received this past April. General Motors Supplier of the Year Award. Our selection was a reflection of our efforts to exceed customer expectations and add value to the operations. It also mark the 14th time we have won the award, making us one of the 10 most recognized suppliers in its 26-year history. Out of GM's, more than 20,000 suppliers worldwide.

I will now hand off the call to Alberto Sada, Nemak's CFO.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Thank you, Armando, and good morning, everyone. I will start my section by providing an overview of the auto industry performance in our main regions. So you have additional context for our results in the quarter.

Regarding North America, U.S. vehicle sales SAAR increased 2% year-on-year, supported by the performance of the U.S. economy. On the other hand, vehicle production showed the 1.7% year-on-year reduction as OEMs continue to follow a destocking strategy. The U.S. consumer has continued to favor light trucks over passenger cars, a trend that has been present for several quarters and has proven positive for some of our customers.

Meanwhile, in Europe, vehicle sales SAAR increased 3.9% year-on-year, also supported by more favorable market conditions, particularly in Eastern Europe.

While vehicle production figures saw an increase of 5.1% year-on-year as the OEMs have been successful in tapping foreign market to sell their vehicles. In this region, we continue to see important mix changes associated with growing customer preference for gasoline over diesel, with gasoline gaining 10 percentage points versus diesel in the last year.

Nemak's second quarter '18 volumes were 13.1 million equivalent units, up 2.3% year-on-year, supported by higher sales in North America. In turn, revenues were $1.2 billion, a year-on-year increase of 6.4% driven by higher aluminum prices, depreciation of the euro against the U.S. dollar, plus the increase in volume already explained.

Nemak reported consolidated operating income of $135 million, 8.9% higher than the year-ago figure. The main reasons for the increase include higher volumes, as already explained, operational efficiencies and lower negative impact from metal price lag, together with positive FX effects.

Our EBITDA was $207 million, slightly higher than last year, but up 10% year-on-year on a comparable basis that is excluding the nonrecurring gain reported last year related to a dispute on taxes in Brazil.

EBITDA per equivalent unit was $15.8, up from $14.7 last year on the same comparable basis. This gain was mainly driven by the positive effect in operating income that I already described. Net income was affected by noncash foreign exchange losses associated with the effect of the devaluation of the Mexican peso on our U.S. denominated debt, coupled with an increase in deferred taxes for the same reason. After this effect, net income amounted to $24 million, a 69% decrease versus last year.

Capital expenditures totaled $93 million during the second quarter, as we continue with our investments to support new product launches in all our product lines as well as increase our efficiency.

Now let me cover our regional results. As mentioned before, the North American auto industry has maintained a historically high level of vehicle sales, while at the same time adjusted production to lower inventories.

Nonetheless, our volumes for the region grew on the back of higher demand for our products, in particular from FCA, which has had a good degree of success with the sale of its crossovers and SUVs, including the new Compass, another vehicle of the Jeep line.

Our revenues in the North American region were also supported by aluminum prices, showing a 5% year-on-year increase. EBITDA for the quarter was $130 million, 5.7% higher than last year on a comparable basis. After excluding the nonrecurring income I described before, on the back of increased sales volumes, a less adverse impact from the metal price lag and operational efficiencies.

In Europe, we reported a 2.4% decrease in volume during the second quarter of '18 due to the reduction in diesel applications, which I just mentioned. We continue to see higher volumes in gasoline engine part, but this was not sufficient to bridge the entire gap. Despite the above, second quarter '18 EBITDA increased 21% year-on-year, as operational efficiencies and foreign exchange gains more than offset lower volumes.

Our volumes in Rest of the World were stable in second quarter, while revenues increased 11.9% due to higher aluminum prices. However, EBITDA decreased by $1 million as higher volumes in Brazil were not sufficient to offset the impact on profitability of lower volumes in China. It is important to highlight that our operations in South America are in the process of ramping up new business, which we expect will help margins recover in the midterm.

With that, I conclude my comments, and we'll now open the call for Q&A.

Operator, please instruct the participants on how to place their questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Vanessa Quiroga with Crédit Suisse.

Vanessa Quiroga - *Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil*

This is related to the aluminum lag. Can you explain how the lag affected less -- to a lesser extent this time? And regarding the pricing of the aluminum, have you been able to align the formula with customers related to reflecting correctly your cost input?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Vanessa, this is Alberto. Yes, related to your question around metal lag. We saw less metal lag this quarter than what we had last year. In total, it was an effect of about $4 million. And I think as it was highlighted by Armando on the call, with the adjustments from the prices that we have done, we have no divergence effect whatsoever on the second quarter. So that's fully fixed.

Operator

Our next question comes from the line of Mauricio Serna with UBS.

Mauricio Serna Vega - *UBS Investment Bank, Research Division - Analyst*

First, I would like to talk a little bit more about the pricing adjustment, just if you could elaborate a little more how it works? I recall, with the metal lag you have 2, 3 months between the, I guess, the estimation of the cost or the price that you would charge your customers for your product. And I just want to know how (technical difficulty) as much as before? And also, if you could maybe provide a little bit more details on the EBITDA improvement, how much came from product mix? How much came from better manufacturing and labor cost? And finally, maybe you can update us on your sales backlog of the whole new businesses, both structural and the electric vehicles with this new recently awarded contracts?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Mauricio. Related to the pricing, let me just remind you how that works. I mean, in this, the way we price our products is with metal formula, that updates, on average, about every 2 months. So the corresponding lag effect that we have, when aluminum obviously goes up, it represent that lag between our adjusting pricing versus our cost and it's on average about 2 months. What we have done with our customers is to incorporate into a formula adjustment mechanisms that help us deal completely with this divergence by incorporating pricing elements out of the primary aluminum market, which is what the reason why we had the divergence between our cost and our selling indicators that we have, in particular for our North American operations.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

So -- yes, let me just add. This is Armando. Related to these issues that we have related to this divergence. I'm glad to share with you that we were able to negotiate with all our North American customers and they have also improved our formula to really reflect our cost. They supported us, and I am glad to mention that this effect is retroactive to General first, so our customers that supported us. And we are very happy with that, that's why I mentioned that we don't foresee any issues related to this, since we have incorporated into new formulas this adjustment on the price that we have -- is mature and that we have been communicating to you.

Mauricio, related to the structural and electric vehicle component business, I'm also very glad to mention that so far, we have booked solid contracts with a lot of premium OEMs as well as mass market OEMs. With contracts worth approximately about $380 million worth in annual revenues.

I would like to also give you a little more detail about out of this $380 million, approximately $150 million are related to electric vehicle components, with $80 million are on battery housings, so this a segment that we are penetrating very rapidly with our new technology, as I mentioned in my script. And this is something that -- with the technology that we have, we are providing our customers with technology to support cooling, which is I think very important for the battery housing. And we have other electric components worth approximately $70 million, and in addition to that, we have already booked business of about $230 million in the structural component business, so a total of $380 million. I'm also glad to tell you that we have a very solid pipeline of additional quotes, a lot of customers, conventional OEMs as other Tier 1 customers that are opening the road for us, companies that in the past who didn't do any business, such as battery makers are already showing a lot of interest in our company -- so we have approximately within $500 million to $600 million worth of quotes at this moment. And we're confident that we will be gaining additional orders in the near future. And I'd like to also tell you that we are still firm with the goal of reaching of $1 billion by 2022 in the structural and electric vehicle components.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

And just to complement the response on your second question, Mauricio, related to the EBITDA improvement. When you do the comparison of the year-over-year, excluding the effect of the nonrecurrent positive affect we had last year of the tax dispute in Brazil, that was favorable for us. We had a $19 million increase, which is comprised about half of that growth effect associated with volume and FX and the remaining half was about 1/4 related to the aluminum lag that we experienced, and even though we experienced it a little bit, it was significantly less than what we had last year and the other quarter was efficiencies in a fewer items mainly in the European operations.

Operator

Our next question comes from the line of Luis Miranda with Santander Bank.

Luis Miranda Valenzuela - *Santander Investment Securities Inc., Research Division - Head of Food and Beverage*

Yes. Armando, Alberto, my questions are -- the first one is related to North America. I think we have seen a very strong growth during the quarter, I just want to know what do you think could be the normalized growth rate in the short term with the visibility that you have -- it might be it's a (inaudible) things a little bit on the high side of what you could be sustaining in the medium term?

The second point is in Europe, when do you think that we could start to see volume growth resuming with this, I mean, when the gas platforms start to outperform the diesel platforms, I don't know if that's the correct way to see it.

And just the final question, just a follow-up in the backlog. This 25% of the backlog that you increased of incremental sales, I would guess, you mentioned, it's basically related to the traditional business, to engine blocks and kit, that's correct? Those are my questions.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes. In North America, we are seeing strong market, even a little bit better than originally expected. I think to some extent, it's related to the tax reform that was introduced in January 1 of this year in the U.S., that provide the consumers with more cash to for them to buy vehicles. We have seen a strong first semester and the industry, analysts are projecting that the second semester is going to be strong as well. Actually, the projection of the industry in North America is about 17 million units in our original budget, we have like about 16.7 million, 16.8 million units, which I think we showed already in our results.

Related to your question, related to Europe, one of the things that we are seeing after the diesel scandal is the following: we are seeing a significant shift of preference by customers or consumers in Europe, switching from diesel to gasoline engines. That has created, over the last 18 months, a drop of diesel penetration of about 10 percentage points. Some of our customers are trying to move as fast as possible to adapt to this new trend. We are also trying to help in that regard. We are, again, building flexibility and also trying to open additional capacity to support this customer shift that was not expected in the first place either by customers or by ourself. But we are moving forward in that regard.

We're expecting that the diesel will stabilize most likely in the next maybe 12, 18 months to a level of about 30%, whereas in the past it was about 50-50, the share between diesel and gasoline. So that has created some issues, operational issues for the OEMs as well as for us, we need to move very fast, and our customers are putting a lot of pressure for us to meet some of these new requirements. And related to your last question, I think, we agree with your point.

Operator

Our next question comes from the line of Juan Tavarez with Citigroup.

Juan Tavarez - *Citigroup Inc, Research Division - Director and Analyst*

My first question is more on your guidance. I don't know if you commented already, but I'm curious if you're still holding to the guidance for EBITDA around $700 million. Just because if we look at the first half and the comments you've made about still showing some strength in the U.S. in second half and the readjustments in your pricing contracts, you're analyzing close to $800 million in EBITDA. So I'm curious if there's any reason that you're expecting, if you are still holding to the old guidance, any contraction in margins into the second half?

And second, maybe you can just give us some -- a little bit of details on your taxes for this quarter? I saw you bit a lot in taxes in this quarter, is there's anything specific there that happened in the quarter? Or anticipation of some taxes? Just to understand what we should expect also from the remaining part of the year.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Thank you, Juan. I would like to answer the first question related to the guidance. As you have mentioned, certainly, we had a good first half of the year. We are confident that we will have a solid second half of the year, and most likely, we will not only meet, but exceed our guidance. I think we will be able, Juan, to give you better color in the next conference call, but certainly, we expect that our results will be above our original guidance that was, let's say, created under different conditions, but we have made solid improvements in our operations as well as volumes are robust and healthy, so we see that, yes, we will have a better year than originally anticipated.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

And Juan, related to the questions on taxes. Yes, certainly, we saw an external effect in this quarter, and that was 100% associated with the depreciation of the Mexican peso against the dollar. And since our accounting is in pesos, we need to reflect the corresponding effect that it has on our U.S.-denominated debt. I think it's important to mention that this is just an accounting adjustment both on the foreign exchange losses that you saw on the financial expenses line as well as the incremental taxes, which is associated with deferred taxes that is generated out of this, let's say, accounting adjustment or accounting foreign exchange loss.

And remember that our balance of currencies is well positioned. Our U.S.-denominated debt is supported by our revenue that we generate and profit that we generate in U.S. dollars as well as the corresponding euro-denominated debt, that we have, which is also, let's say, balanced with our exposure to euro currency business.

So all in all, the effect on taxes was externally based on this depreciation, if we see that currency moving the other way, we will see different movement both in the foreign exchange gain/loss line as well as the corresponding effect on taxes -- accounting effect on taxes due to this situation of the deferred taxes from this extraordinary loss. The cash taxes will not change from what we have seen in previous years, so that should be stable.

Operator

Our next question comes from the line of Augusto Ensiki with HSBC Global Asset Management.

Augusto Akihito Ensiki - *HSBC, Research Division - Latin America Analyst*

I'm sorry if it's already been asked, but just curious, could you give us a little bit more detail in terms of the revenue that was from structural components and EV in the quarter? And if you could remind me what it was in the first quarter as well if you just give a full first half number?

And secondly, I'm looking at revenue per unit. Just wondering why, for North America specifically, you had as flat to slightly down on a year-over-year basis. I thought it would be up given aluminum prices, but is that related to the new pricing agreements that you have with the customers?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Augusto, so let me just answer your first question and I hope you can help me with the second follow-on. But related to the structural components and EV business, that is, let's say, ramping up according to our plan. And in the quarter, we have a rough estimate of around $40 million worth of revenue associated with that business.

You should expect the year to be in the neighborhood of $150-plus million for structural and that's in line with a ramp-up of our business to reach the $380 million backlog that we have highlighted. You had a second question on revenues, can you please explain that again?

Augusto Akihito Ensiki - *HSBC, Research Division - Latin America Analyst*

Sure. I was just looking at -- I know we don't really focus too much on per unit revenue, but when I'm looking at North America 2Q '18 versus 2Q '17, on a unit revenue basis for North America it was down, I guess less than 1%, but I thought it should be trending upwards given price pass-through or not and whatnot?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, when we see the total revenue figures, I have to do the per unit basis to see exactly what moved. That moved singularly up and down depending on the mix, but all in all, the trend was that when you compare year-on-year, we see about 60% of the increase in revenue associated with the metal pricing adjustments that we saw, and for which we have explained on the lag and the [indiscernible] that we had in the past. But we'll have to check and get back to you exactly to see what the corresponding mix effect that may have triggered a little bit adjustment on the pricing side. I think it is also important to highlight that when you do the calculation on revenue, you need to adjust it for the $80 million of extraordinary effects we had in Brazil back in 2017. And that may help you bridge a little bit better the movement.

Augusto Akihito Ensiki - *HSBC, Research Division - Latin America Analyst*

Sure. One last question. You mentioned, I think, it was mostly in the last quarter, but additional cost associated with new product launches and such. Is that still in the second quarter? Or is that kind of going away as those ramp up?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Augusto, no. This is something that we have been able to correct. We have -- as we have already mentioned, improved efficiencies not only in terms of labor cost, manufacturing cost as well as launching expenses. We had extraordinary launching expenses in the first quarter due to many products that we were launching. And in addition, as I was mentioning, we have, in Europe as well, additional expenses related to working overtime to support some of this shift that we have seen from diesel into gasoline. And unfortunately, our customers who were not paying for all these additional expenses, so fortunately, we are more stable and we do not foresee having this issue in the next future.

Operator

Our next question comes from the line of Alejandro Azar with GBM.

Alejandro Azar Wabi - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

Just a quick follow-up regarding your agreement on the aluminum prices. Did you mention that the agreement was retroactive?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, I did mention that, Alejandro, that the agreement was retroactive through January 1, our main customers in North America, yes.

Alejandro Azar Wabi - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

And would you explain or give us more color regarding how much would that benefit would be? And in which quarters? Or maybe, I don't know, if you can -- you're going to record it in 2018 or 2019?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

I think the that bottom line is that we have negotiated with our customers to eliminate these effects that we have from this mismatch between primary aluminum and secondary aluminum. And we do not foresee to have this effect going forward. And we reported, during the first quarter, some impact related to that. Fortunately, we were able to correct that, but we do not foresee. The only element, of course, will be metal lag and which is normal part of our business. We're are seeing -- and I think that is, to some extent, positive, not only for our customers, but also for us, that the aluminum prices are going down, they are stabilizing. So hopefully, we will be able also to recover a portion of what we have already reported on the metal lag.

Alejandro Azar Wabi - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

So just to be clear, so we shouldn't expect a compensation on your previous losses from this effect, right?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Well, it's fully covered for 2018. For 2017, that's sample.

Operator

Our next question comes from the line of Gilberto Garcia with Barclays.

Gilberto Garcia - *Barclays Bank PLC, Research Division - Assistant VP & Equity Research Analyst*

Do you have any comments on Ford's announcement that they will cancel most of their sedan production in North America? How is that going to impact your volume, your investments and so on?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, Gilberto. Ford made the announcement that they were exiting the passenger -- small passenger vehicle segment. And that is related -- let me just give you a little bit of background. If you take a look at, for instance, the consumer preference in the U.S. mainly, we have seen a big shift in consumer preference. If we go back to 2014, approximately 50% of the total vehicle sales were in the passenger cars and the other 50% were in SUVs and trucks. If we take a look at today's environment, we see that the mix has changed significantly and now it's about 70% SUVs, small SUVs and pickup trucks and 30% is passenger cars. This is a shift that is -- even some of our customers were not expecting, but that's a reality.

We saw FCA making announcement to exit that segment coproduce at all and we are seeing now Ford. So far, Gilberto, we have not seen any effect. And in conversations with top-ranking officials from Ford, what they are telling us, and this has been communicated even at the level of Jim Hackett is that they are not exiting this market, what they are doing is, according to them, is changing the design of the vehicle. But they like to redesign some of the passenger cars and convert those to small SUVs, which is what the American public prefers now. So far, as I indicated, the announcement was made that they will exit these vehicles by 2020, so we have not experienced any effect. And Ford is confident that they could retain market share with the introduction of these new models or new vehicles that they are, at this moment, redesigning.

Gilberto Garcia - *Barclays Bank PLC, Research Division - Assistant VP & Equity Research Analyst*

Okay, great. And a couple of follow-up questions on the results. Just to clarify on the retroactive effect of your agreement with your customers. Was there any benefit that you included in the quarter's EBITDA related to the index divergence from the first quarter?

And below the operating line, the FX loss was larger than the FX gain that you reported in the first quarter, even though the FX movement was of similar size. Can you explain why that happened?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Gilberto, to your question about the retroactive effect of the pricing adjustments with our customers. Yes, that accounted for the full year and we booked that on this quarter. Am I right? So that takes care of the entire divergence on this quarter.

And related to your question about the foreign exchange losses. If you see the effect of the currency, the peso-denominated currency depreciated close between 8% to 9% quarter-over-quarter. So you apply that effect into the balance of our debt, that is in U.S. currency, since we have a reporting currency in pesos, we need to reflect that adjustment on the value of our debt. The debt that is denominated in U.S. currency is close to between 55% to 58%. So if you apply that exchange rate, you get that corresponding foreign exchange loss in the quarter.

Operator

(Operator Instructions) Our next question comes from the line of Travis Pascavis with Hartford Investment Management.

Travis Pascavis

Just wanted to get a little more information on the CapEx's percentage of sales, it seems like that's been coming down. Is that consistent with your launch schedule? Is it -- can you kind of give some color around the normalization of CapEx spend?

And then maybe just if you can make some comments on potential tariffs and maybe how that might play out in the business going forward given that it's kind of a switch, very quick change?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, thank you, Travis. Good questions. What we are seeing in the industry, especially on the powertrain side of the business, is the following: customers are not fawning, as they were just a few years ago. We're introducing new engines or new transmissions, what we are seeing is that customers, OEMs today are facing several challenges because the industry is changing fast. And they prefer to invest more in electrification, more in cab sharing as well as vehicle connectivity, autonomous driving and so on.

So we will see the need for less CapEx, our customers are indicating that they like to maintain the existing powertrains, especially engines and transmissions longer. They will make small modifications and that implies, Travis, that we will have to invest less. This year, we're projecting to stay at a level of about $390 million and we expect that, in the following years, our investment of CapEx for the powertrain business will be significantly reduced. Where we see that we will invest in CapEx and CapEx is certainly on the new electric and structural business as well as additional machining if that makes economic sense. But yes, we have more discipline in terms of CapEx and we are projecting, also, to improve our cash flow generation.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes. And, Travis, related to your second question on the effect of tariffs. I think -- I mean, yes, we have seen the U.S. is very active in terms of trying to push for a couple of tariffs. We saw the aluminum and steel tariffs that they placed triggered by the Section 232 investigation. And I think we have highlighted that in the past, that has no effect on our products, that applies mostly for the raw material side on the aluminum, plus our operations in the U.S. are fully reliant on local suppliers. So we have seen no sign on the revenue -- no effect on the revenue side, nor we have seen any effect on the cost side, aside from all this volatility that has generated and for which we have this cost divergence and lag.

And there is a subsequent 232 investigation related to automobile manufacturing and auto parts, that's an ongoing discussion. There is a lot of people and companies in the U.S. which have opposed such situation, and the fact that it may have a detrimental effect on their business as well as overall their cost. And what they have highlighted this -- in the event that this happens, they will most likely pass on any subsequential effect of cost to the ultimate consumers. So that will apply also to ourselves, we'll essentially pass on any effect if it applies any tariff on our end. So far, we have seen no effect on us.

Operator

Our next question comes from the line of Jean Bruny with BBVA.

Jean Baptiste Bruny - *BBVA Corporate and Investment Bank, Research Division - Research Analyst*

Just have one little doubt regarding the backlog. You're just mentioning in your communique that $150 million, just to clarify if it's just for the quarter? For the first half of the year? And how much of this is for structural?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, the quarter -- the $150 million backlog that we highlighted for the quarter, that was primarily the traditional business. We had one project, a very strategy project that Armando shared on his discussion that we have in Europe related to electrical components, but the majority was related to the traditional business on the $150 million that we reported for the quarter.

Jean Baptiste Bruny - *BBVA Corporate and Investment Bank, Research Division - Research Analyst*

Just for the quarter, so it's summing up to the $125 million you're reporting for this quarter, no?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes. So if you add them both together, you have there $200-plus, $260 million, $270 million of new business.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

I think it is worth mentioning that over the last 24 months, we have received approximately about $1.7 billion worth of new business, which about half will be incremental.

Operator

Our next question comes from the line of [Sanal Sodhi] from Morgan Stanley.

Unidentified Analyst

Just a question on Europe. So are you seeing any impact in the current quarter and for the fourth quarter? We have heard news around slower ramp ups due to the new testing norms from some of the OEMs, are you seeing that impact in your European side?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, that's a good point, [Sanal]. Certainly, in Europe, and I think important for us to clarify that issue. They have a new regulation that is put in place effective in September in which OEMs or customers, will need to verify all vehicles with all combinations possible. Let me just give you an example. In the past, if an engine was validated on a typical, let's say, golf vehicle, that engine could be used, also, on other models by the Volkswagen group just to give you an example. With the new regulation in Europe, it's significantly more strict and they will require that OEMs validate all configurations. That has created a tremendous backlog in terms of testing, and some of our customers have already announced potentially that they will have to either start or stop production for a few days or have to warehouse some of the vehicles, which is what we are seeing now. There is some concerns, because these new regulation, again, potentially will affect the release of some new vehicles with new configurations, it could be engines or transmissions. Yes, we are already aware of that potential issue. However, so far, we have not seen yet any volume reduction. Certainly in the event that a volume reduction happens, we will communicate that in the next conference call. Our customers are rushing as fast as possible trying to get validation, especially on new vehicles with new engines or new transmissions.

Operator

There are no further questions at this time and I'd like to turn the conference back over to Mr. Althoff for any additional or concluding remarks. Sir?

Adrian Althoff - *Nemak, S. A. B. de C. V. - IR Officer*

Thank you, operator. I would just like to thank everyone for participating in today's call. Please feel free to contact us if you have any follow-up questions or comments. Have a good day.
