Orbia

Second Quarter 2023 Earnings Results

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CORPORATE PARTICIPANTS

Gerardo Lozoya – *Investor Relations Director*

Sameer Bharadwaj – *Chief Executive Officer*

Jim Kelly – *Chief Financial Officer*

PRESENTATION

Operator
Good morning and welcome to Orbia's Second Quarter 2023 Earnings Conference Call. As we turn to slide 1, all participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star and then one on your touchtone telephones. To withdraw your questions, you may press star and two. Please also note, today's event is being recorded.

At this time, I'd like to turn the floor over to Gerardo Lozoya, Orbia's Investor Relations Director. Sir, you may begin.

Gerardo Lozoya
Thank you, operator. Good morning and welcome to Orbia's second quarter 2023 earnings conference call. We appreciate your time and participation today. Joining me today are Sameer Bharadwaj, CEO; and Jim Kelly, CFO.

Before we continue, a friendly reminder that some of our comments today will contain forward-looking statements based on our current view of our business, and actual future results may differ materially. Today's call should be considered in conjunction with cautionary statements contained in our earnings release and in our most recent Bolsa Mexicana de Valores report. The Company disclaims any obligation to update or revise any such forward-looking statements.

Now, I would like to turn the call over to Sameer. Sameer?

Sameer Bharadwaj
Thank you, Gerardo, and good morning, everyone. At Orbia, we continue to be guided by our purpose to advance life around the world, while harnessing the power of material science and innovation to serve our customers' needs, address world challenges, and provide sustainable solutions. Through our global operations in over 50 countries, we are creating basic and advanced materials and solutions that are linked to three main themes: water and food security, decarbonization and energy transition and information access and connectivity.

Now moving on to slide 3, I would like to share a high-level overview of our performance for the second quarter of 2023. The second quarter was challenging for Orbia, due primarily to weak demand and pricing and slowed building and construction activity in certain regions, most notably in Europe. Compared to a strong second quarter a year ago, profitability decreased in Polymer Solutions, Building and Infrastructure and Precision Agriculture, which was partially offset by strong margins achieved from active pricing management and continued strength in Fluorinated Solutions and Connectivity Solutions.

Quarterly revenues totaled $2.2 billion, down 18% year-over-year. EBITDA decreased by 27% to $444 million, with an EBITDA margin of 20.4%, or roughly 250 basis points below the prior year level. Finally, our operating cash flow was $217 million, an increase of 62% from the prior year.

Despite the challenges stemming from the current operating environment, our long-term fundamentals remain intact, and we are committed to achieving our growth targets, as we reiterated at our Strategy Update in June.

At this time, I will turn the call over to Jim to go over our financial performance in further detail.
Jim?

Jim Kelly
Thank you, Sameer, and good morning, everyone. I'll start by discussing our overall second quarter results.

Turning to slide 4. On a consolidated basis, net revenues were down 18% year-over-year, reflecting lower sales in Polymer Solutions, Building and Infrastructure, Precision Agriculture and Connectivity Solutions. These results were driven by a slowdown in demand and weaker end markets and as a reminder, are compared to a very strong prior-year quarter. These factors were partially offset by higher revenues in Fluorinated Solutions as a result of stronger pricing.

EBITDA of $444 million decreased by $165 million year-over-year due to softer demand and lower prices across Polymer Solutions, Building and Infrastructure, and Precision Agriculture, partially offset by EBITDA gains in Connectivity Solutions and Fluorinated Solutions. These results included an unfavorable impact from foreign exchange of approximately $25 million as well as additional one-time items totaling $26 million in the quarter, comprised primarily of impacts related to raw material supply disruption and to restructuring charges.

Operating cash flow of $217 million increased by $83 million, or 62%, compared to the prior year quarter, reflecting effective working capital management and lower cash taxes paid, partially offset by lower EBITDA. Free cash flow in the quarter was $30 million, an increase of $41 million year-over-year, due to the increased operating cash flow, partially offset by higher capital expenditures of $162 million, a year-over-year increase of $53 million. The increased capex supports Orbia's ongoing growth initiatives, which we highlighted as part of our Strategy Update in June.

Our effective tax rate was 80% for the quarter, as compared to approximately 25% in the prior year period. The increase was due to impacts from the appreciation of the Mexican peso during the quarter as well as the settlement of ongoing tax audits. The impact of the peso is caused by the fact that our reporting currency in Mexico is the US dollar, while our taxes are filed in pesos. The change in the peso value applied to our US dollar net monetary asset balance in Mexico is deemed to be a taxable item, and in the quarter added approximately 41% to our tax rate. The statutory rate for the quarter based on the regional earnings mix was 24%.

During the quarter, Orbia continued to maintain a strong balance sheet, while investing for growth and returning value to our shareholders. The Company paid a total of $120 million, as the first and second installments of the ordinary dividend approved at the Annual Shareholders Meeting, which was held on March 30, 2023.

Turning to Slide 5, I'll go through our quarterly performance in more detail by business. In Polymer Solutions, second quarter revenues were $645 million, a decline of 39% year-over-year, largely due to lower prices in general purpose PVC and lower volumes, reflecting weaker demand due to a weaker construction market and a raw material shortage due to operational issues at one of our suppliers. Second quarter EBITDA was $102 million, a decrease of 63% year-over-year, with an EBITDA margin of 15.9%, a decrease of approximately 1,050 basis points. These declines were primarily driven by reduced prices and volumes, partially offset by lower raw material costs and improved year-over-year results in the derivatives business.

In Building and Infrastructure, second quarter revenues were $698 million, a decline of 11% year-over-year. Results were impacted by lower volumes, particularly in Europe, and lower prices in certain Latin American and Asian markets. Second quarter EBITDA was $74 million, a decrease of $25 million year-over-year, with an EBITDA margin of 10.7%, a decrease of approximately 190 basis points. This was driven primarily by downward pressure on European markets due to the ongoing weakness, as well as the lower volumes and prices I just referred to and a one-time cost related to business optimization.

Moving on to Precision Agriculture, second quarter revenues were $288 million, a decline of 10% year-over-year, due to softening demand, particularly in the US, Europe and Africa, reflecting weaker economic and adverse weather conditions. The decline was partially offset by strong performance across China, India and Turkey. Second quarter EBITDA was $41 million, a decrease of $18 million year-over-year, with an EBITDA margin of 14.2%, a decrease of approximately 410 basis points. This was largely due to the lower demand, foreign exchange impacts and ongoing hyperinflation impacts in Turkey.

In Connectivity Solutions, second quarter revenues were $338 million, a decline of 6% year-over-year. This was driven by somewhat lower demand stemming primarily from slower than anticipated deployment of US Government funding to expand broadband access, which was partially offset by strong prices. Despite the decrease in revenue compared to the prior year quarter, second quarter EBITDA increased 11% to $109 million, with an EBITDA margin of 32.3%, an increase of approximately 500 basis points. The higher earnings were driven by strong pricing and a stabilization of material costs.

Fluorinated Solutions had another strong quarter, with second quarter revenues of $263 million, up 18% year-over-year. These results were primarily driven by favorable pricing across the product portfolio, as well as higher volumes. Second quarter EBITDA was $116 million, an increase of $30 million year-over-year, with an EBITDA margin of 44.2%, an increase of approximately 560 basis points. This was largely due to the strong pricing that more than offset unfavorable foreign exchange impacts and spending on growth investments.

Sameer, I'll turn it back to you to discuss our full year guidance and market outlook by business.

Sameer Bharadwaj
Thank you, Jim. On slide 6, I will provide an update to our outlook for 2023. During the second quarter of 2023, several of Orbia's end markets, particularly in the building and construction sector, experienced lower demand and weaker pricing. We remain cautious about the level of economic activity in the second half of the year in a number of regions due to ongoing impacts of monetary policy tightening, exchange rate volatility, inflationary challenges and the war in Ukraine. Given the decline in absolute levels of polymer prices and the weaker market environment I just described, we believe our revenues will be lower than prior year by mid to high single digit percentages for 2023.

Our team continues to work to mitigate the impacts of these factors on our results through fiscal discipline, commercial and operational excellence and business optimization efforts, and we are targeting EBITDA of approximately $1.65 billion for 2023. In addition, we are managing our capital expenditures in line with current market conditions and now expect capex guidance to be in the range of $550 million to $650 million for 2023, which includes maintenance spending and growth-related investments.

Finally, due to the ongoing strength of the Mexican peso, we are revising our effective tax rate guidance for the year to between 44% and 47%.

Looking ahead in each of our business segments, beginning with Polymer Solutions. We expect the softer business performance to continue into the second half of 2023 due to the increased availability of PVC and weaker demand. Pricing for general purpose PVC is expected to recover slightly but to remain at low levels, with pricing for specialty PVC expected to remain stable at current levels. Chlorine prices are expected to decrease but remain at historically strong levels. Caustic soda prices have decreased significantly from first quarter 2023 highs, due to oversupply and weaker end markets.

In Building and Infrastructure, we expect difficult market conditions to continue in Europe. Western Europe continues to be weak, while we see some stabilization in Central and Eastern Europe. To help mitigate these impacts, the business is focused on cost management and progressing the integration of the recent Bow and Vectus acquisitions in order to deliver the expected results.

In Precision Agriculture, we expect a sequential slowdown in Q3 due to seasonality and an uptick in Q4, as farmers get ready for the next season. Overall, we expect second half results to improve as compared to the second half of last year. We remain focused on progressing our growth initiatives across extensive crops, services, greenhouse projects and digital farming.

In Connectivity Solutions, we expect a temporary slowdown in demand in North America through the reminder of the year. This is partly due to the recently announced US Government Broadband Equity Access and Deployment Program of approximately $42 billion. As this funding becomes accessible to customers, investment in the US and fiber deployment is expected to pick up in early 2024. We are continuing to expand our production capacity in order to meet the market requirements and capture growing demand. We are also expanding our adjacent products and services in order to provide our customers with end-to-end solutions.

And finally in Fluorinated Solutions, demand and pricing are expected to be generally stable, in line with normal seasonal patterns for the rest of the year. We continue to see increasing interest in our next generation refrigerant gases and momentum in the conversion to medical propellants with lower global warming potential. Our projects to manufacture lithium-ion battery materials in the United States are on track.

In closing, as we move ahead into the balance of 2023, we remain focused on operational, commercial, and financial discipline across our business, while we continue to execute our strategy, develop innovative products and solutions to meet our customers' needs, and deliver value to our shareholders. Despite the near-term challenges, we remain committed to the growth strategy that we shared in our Investor Update and believe that our long-term value proposition is intact. As always, I am proud of our team's unwavering dedication to our purpose and commitment to our values.

Thank you for joining us today and for your continued interest in Orbia as we advance life around the world together.

Operator, we are ready to take questions at this time.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time we'll begin the question and answer session. If you would like to ask a question, please press star and one. If you'd like to withdraw your question you may press star and two. If you are using a speakerphone, we do ask that you please pick up the handset prior to pressing the buttons to ensure the best sound quality. Once again, that is star and then one to join the question queue.

Our first question today comes from Leonardo Marcondes from Bank of America. Please go ahead with your question.

Leonardo Marcondes
Hi, guys. Thanks for taking my questions. So my first question is regarding the Polymer Solution business, which represented a significant drop in EBITDA and margins quarter over quarter, right? So I would like to know if you guys could please quantify by how much this raw material disruption back to the quarter? And what should we expect in terms of margins for the remainder of the year?

My second question is regarding Koura. Koura has been doing really well, right, with very high margins. So I would like to know if you could provide your expectations for margins for this business over the next quarters. And if at some point we should see a normalization emerge. Thank you.

Sameer Bharadwaj
Thank you, Leo. I'll let Jim respond to your first question on the one-time impact of the raw material shortage that we experienced, and then I can say a little more about what's happening in the Polymer Solutions business over the coming months.

Jim Kelly
Sure. Thanks, Sameer. Hello, Leonardo. So, yes, related to the [indiscernible] business, Polymer Solutions, there was a single one-time event in one of our suppliers where they had an incident in one of their plants that has since been remediated. So, supply is normalized now, and it did have an impact of about $25 million on our EBIT in the quarter. So we would not expect to see any further impact from that in future quarters.

Sameer Bharadwaj
Thank you, Jim. And then if you look at the PVC business overall, I would say caustic soda, chlorine PVC business overall, we are seeing a nice rebound in PVC prices in the first quarter, which then receded in the second quarter. And we haven't seen the rebound of the markets within China that everyone was expecting to see. And that has continued to keep prices depressed in the short term. Having said that, if you look at some of the expert analyst reports out there, they are expecting a mild rebound over the course of Q3 and Q4, and that should help stabilize the business in the short term. Meanwhile, with caustic soda and chlorine, caustic soda prices have now retreated from their all-time highs, and while chlorine remains at historically high levels, we are beginning to see some decline in merchant market chlorine as well.

Your second question was on Koura's performance and its margins. And you know the Fluorinated Solutions business, as many of you know, is very well positioned in the fluorine chain, with the unique access to fluorine that we have with our mine in Mexico. And as I have talked about this many times in previous earnings calls, as the decade continues demand for fluorine, particularly in new applications, will continue to grow and supply will remain constrained. So, our long term view is the fluorine chain is favorably positioned to benefit over the long term, both in existing applications and in new applications.

Now, in existing applications, particularly the refrigerant gas business, where much of our participation is in regulated markets, where there are F-gas quotas, and these quotas decline over time, and as volumes decline, prices go up, and I talked about this at the investor update call, where eventually you would expect the pricing of current generation refrigerants with the quota to converge with the declining prices of the next generation refrigerants. So, that is what has contributed to strength in Koura's earnings across the board in all of the segments we participate in.

Now, of course the cooling season is getting over, and so as we had indicated in the press release, going forward it will be normal seasonal patterns in Q3 and Q4. And over the next couple of years we will continue to see the transition from the current generation refrigerants to the next generation refrigerants. And then eventually in '26, when our new assets for battery materials are in place, you know, that's when you will see some contribution from the energy materials business to Koura.

So hopefully that answers your question on Fluorinated Solutions, Leo.

Leonardo Marcondes
Yes, that's very clear. Thank you, guys.

Sameer Bharadwaj
Thank you.

Operator
Our next question comes from Pablo Monsivais from Barclays. Please go ahead with your question.

Pablo Monsivais
Hi. Good morning, Sameer, Jim and Carlo. Thanks for taking my question. I have two simple questions. The first one is on the Polymer Solution business. Which metrics are you now more closely monitoring to assess a potential inflection point? That will be my first one.

And the second one is on Precision Agriculture. Do you think that as soon as next year we will start to see some clear progress on your extensive crops initiative? Thank you.

Sameer Bharadwaj
Very good, Pablo. Let me take your question on Polymer Solutions in terms of inflection point. As you know, we've discussed this before, our long term thesis on Polymer Solutions is one of structural imbalance, where supply growth will not keep pace with demand growth. Having said that, in the near term we are in a situation of weakened demand due to slowdown in building and construction in Europe and North America combined with increased supply. Now, in the very short term increased supply was caused by two factors. One is the COVID related shutdowns in China, which slowed down their economy. And the second factor was the very high prices of caustic soda and chlorine, which created an incentive for domestic US producers to produce caustic soda and chlorine and then sell the excess PVC at low prices.

Now, the factors that we closely monitor and look at is what's going on in China in terms of rebound in their demand. And so that's one of the things we closely monitor. The second thing is caustic soda and chlorine prices are now coming back down, which reduces the incentive for US domestic producers to overproduce PVC and increase supply. So, our expectation is, things, in a way normalize over the next several months. Now, when you go look at the expert analyst reports, the outlook is for basically over the next couple of years supply and demand should be in balance and we should not see massive hikes in PVC prices in that period. But after that, utilization rates are expected to go up in a significant way. And so once again, we are focused on the long term. And in the short term there are a few factors that help with the stabilization of the business. And those are the ones that I just talked about.

And then the second question is on Precision Agriculture. Now, as you've seen here, we went through a very challenging period in the second half of last year. But since then revenues came back nicely in Q1 and continued in Q2. And in fact, would have been even better had it not been for the floods in California and the impacts of the earthquake in Turkey. Now, we are highly focused on specific opportunities in each of our regions on four growth vectors, the extensive crops, the services business model, the turnkey greenhouse solutions as well as digital farming. And at this point we have identified specific opportunities, whether it's in the United States, Brazil, Mexico, Turkey, China, for extensive crops, where we have fit for purpose solutions at the right cost level to encourage adoption in these applications. And we are in the process of building out the teams on the ground to go after these opportunities. And so we should begin to see some impact in the middle of next year, as some of these opportunities begin to mature.

Pablo Monsivais
Very clear. Thank you very much.

Sameer Bharadwaj
Thank you, Pablo.

Operator
Our next question comes from Luis Corrado from Banco UBS. Please go ahead with your question.

Luis Corrado
Hi. Thanks for taking the questions. I have basically two questions here. The first one, last year you provided the long term guidance, and this year basically, you know, the management review to the guidance, or, basically pushed one year forward. And when we look to the communication that you provided in this quarter, in terms of the EBITDA and I would say guidance for the year, we saw somehow slightly changed from at least to approximately 1.65. And when we look to the results from an overall perspective, we see several challenges from some of the industries, at least in the short term. So I just want to have a bit more color in terms of the EBITDA progression in order to meet the short term and the long term guidance.

The second question is more about capital allocation. So, leverage reached, it's higher than 2 times net debt to EBITDA. It's a comfortable level and within the range that the company mentioned, but if we see the EBITDA trends that we are seeing for some of the products and some of the sectors, we might see leverage potentially going to be higher. So I just would like to understand how this could affect the dividend payment/I would say appetite for further acquisitions. Thank you.

Sameer Bharadwaj
Very good, Luis. So look, let me try and address short term, long term and then your questions on growth and leverage and how it impacts our capital allocation and dividends. In terms of the short term guidance, first of all, again, our philosophy has always been to be focused on the long term and be totally transparent about the short term. And in fact, when we issued guidance at the end of Q1, you know, despite a very strong start to the year we issued a guidance of 1650 or higher. And at that point, quite frankly, it was too early in the year to know how the year is going to shape up. Given the uncertainties and with the relentless increase in interest rates, it takes time for the impact of these interest rates to take effect and affect economic activity, particularly building and construction. And so at that time we said 1650 or higher, if the market conditions improved in the second half of the year, that higher is possible.

Now, based on what we see, we are seeing a slowdown in building and construction activity, particularly in Europe, and also to some extent in North America. And we had taken that into account, even when we issued the guidance at the end of Q1. At this point, we believe that it's prudent to stick to our guidance and be cautious about the second half of the year. So that explains our thinking on the second half. And of course, we are doing what any good management team should do in terms of being disciplined with respect to costs and driving revenues so that we have good fixed cost coverage, and demonstrate the resilience of Orbia’s businesses during this time.

Having said that, not much has changed since we gave the investor data update. The PVC markets were weak then, the PVC markets are weak now, which doesn't change our long term thesis on the structural imbalance. If you think about our growth projects, we are looking at a PVC expansion. And as

I had indicated during the investor day update, today, we are focused on engineering and the engineering for a project as large as this takes close to a year and a half. And we will be at a point of making large capital commitments only towards the end of next year. And we maintain the flexibility to fine-tune the timing and the scope of the project. The second project, and the third project I talked about were both in Fluorinated Solutions, the ones on LiPF6 and PVDF, and those are solidly on track and full steam ahead. And the fourth project, which is a collection of new plants that we are building in various parts of North America, in Canada and the United States for our Connectivity Solutions business, those are 100% on track.

So in terms of our long term growth outlook, what's happening in the very short term doesn't really impact the long term. Now, of course the long term, the end state can vary by plus or minus 6 or 12 months, which is what I had even said at the investor update call. So that doesn't fundamentally change.

Your next question was around leverage. Now, of course the leverage is a ratio which is a function of net debt to the trailing 12 months EBITDA. And naturally, if you take the last two quarters of last year and the first two quarters of this year, that ratio has crept up. Having said that, when we look at our long term planning, we have taken all of this into account. And as Jim has stated earlier, our goal is not to exceed a net debt to EBITDA of 2.5 for an extended period of time of, let's say, more than 6 to 12 months, and then bring it back to those levels. And all of our long term planning, as stated at the investor update call, the dividend will be intact. We are absolutely committed to the dividend. And it's one of the most important features of Orbia's stock, where Orbia is for investors who are in this for the long term. And over the long term, we will create an incredible amount of value. And for those investors who are in it and are patient for the long term, the dividend is very important. And so for us the dividend will remain, so there's no questions about that.

So hopefully that answers all of your questions, Luis.

Luis Corrado
Thank you very much. Very clear. Appreciate that. Thank you.

Sameer Bharadwaj
Thank you.

Operator
Our next question comes from Alejandra Obregón from Morgan Stanley. Please go ahead with your question.

Alejandra Obregón
Hi. Good morning, Sameer, Jim, Gerardo. Thank you for taking my question. I actually have a follow up on your strategic capex and some of the projects that you just mentioned, Sameer. The first one has to do with PVDF. It seems to be that there's a lot of things happening in the EV space, onshoring trends, Inflation Reduction Act, so things are unfolding rather quickly, and you mentioned that this project is on track. So I was hoping to hear if you can just elaborate a little bit more as to where is this project at this stage? How is it evolving? Whether you could be perhaps thinking of a different timeline, given the quick turnaround in the space, and the very big opportunity for the EV space and how PVDF is important for that.

And then the second question, also having to do with strategic capex, so you mentioned these three projects that are part of your long term strategy, but you're also lowering your capex guidance. So I was hoping to hear if maybe in your strategic focus some projects have gained relevance over others, given the current conditions in each of the segments, or are you still thinking of maybe PVC as the biggest project? Anything that could help us understand perhaps the pecking order of your capex here. Thank you.

Sameer Bharadwaj
Sure. Yes. Very good, Alex. Let me try and address them. Look, first and foremost, you don't make long term commitments based on short term, high frequency information, or short term considerations, right? I mean, it may fine-tune timing of your projects or some tweaks to your projects, but you don't typically make long term commitments based on short term information.

Now, speaking of energy materials, and here we have a very significant effort in both PVDF and LiPF6, and let me remind everyone, PVDF, we are doing this as a joint venture with a Belgian company, Solvay. And this has been structured as a 5149 JV. Solvay is the world leader in PVDF for batteries. This will be the first plant in the United States catering to the EV industry, and Solvay is the beneficiary of the DoE grant for this project as well. And it will partially benefit the JV. We had signed an MoU with Solvay back in November, and now we are in the final stages of finalizing the definitive agreement. But the engineering is going on in parallel. So this project is expected to come online sometime in 2026, potentially in the second half of '26. You know, timing varies depending on how soon you can build these plants, but that's when it's expected to start contributing.

The second project, which is equally important, and this is 100% owned by Orbia, is an LiPF6, which is another key battery additive which is used in the electrolyte. And for this, we have secured a license from the Japanese leader, Kanto Denka. That's done. That's finalized. And the technology exchange is going on even as we speak. The engineering work has begun. And the timeline for this project is also sometime the middle to the end of 2026. And for this project, we have received a $100 million grant from the Department of Energy.

Now, both of these are incredibly high value projects. And as I've indicated earlier in terms of the returns, the returns are in the range of 2 to 3 times EBITDA multiple on these projects. And you can imagine, you can do the math on the amount of battery capacity that is needed over the course of the decade and that we might have to exponentially grow this capacity over the following years. So these two projects are going to be very important to Orbia's growth going forward.

The second question was on capex, right, the capital allocation priorities Yes. So, now in terms of capex for the year, of course when you're going through tough times, you exercise discipline, you prioritize the most important projects, both in the maintenance capital side and the growth capital side. Now, of course, it does not affect the fundamental growth projects, the ones that we talked about on investor day, but the small reduction that you see is simply just us exercising good discipline and making sure we time the maintenance capital and growth capital appropriately. But this is not causing any delay in any of our growth projects. As I had mentioned earlier, we have given you the timing of the PVC project earlier, and then I've also given you the timing of the LiPF6 and PVDF projects. Those are multi-year projects, and so once you get started on those, the engineering takes time. And those are on schedule.

Alejandra Obregón
Thank you, Sameer. That was very clear.

Sameer Bharadwaj
Thank you.

Operator
Our next question comes from Regina Carrillo from GBM. Please go ahead with your question.

Regina Carrillo
Hi, good morning. Thank you, Jim, Sameer and Gerardo for taking my question. I know, Jim, that you partially explained this earlier, but I was wondering if you could walk us through again why we're seeing a net positive effect on foreign exchange in the free cash flow.

Jim Kelly
Specifically on the tax rate, Regina, is that the one you're talking about?

Regina Carrillo
I'm talking about the $18 million that we see for the second quarter. Yes.

Jim Kelly
In FX overall, you're saying?

Regina Carrillo
Yes.

Jim Kelly
Okay. So it's largely due to exposure to the Mexican peso and a combination, really, of the fact that we have some debt in Mexican pesos. And we see a negative implication on that when the peso strengthens, as well as the fact that particularly in our chemicals businesses, so in Fluorinated Solutions and in Polymer Solutions we tend to have quite a number of our operations in Mexico, and therefore, a lot of our operating costs are there and denominated in Mexican pesos. And with the strengthening of the peso, which has been considerable recently, those translate into higher US dollars. So it’s really as simple as that.

I think an important thing to highlight, that I did talk about in the script, is the effect on the tax rate, which is considerable. So you would have seen that we've got approximately an 80% tax rate in the quarter related to the strength of the Mexican peso. And that is due to the fact that we have a reporting currency of US dollars, yet our tax filings are in pesos. So essentially our net monetary asset position in US dollars ends up translating into far more pesos, and it's essentially seen as being a gain by the Mexican SAT tax authorities, and a taxable gain. So that's what's really driving the considerable increase in the tax rate that you've seen. To me, that is the most critical impact of the Mexican peso in the financials.

Regina Carrillo
Perfect. Thank you, Jim.

Jim Kelly
You’re welcome.

CONCLUSION

Operator
And once again, if you would like to ask a question, please press star and one. To withdraw your questions, you may press star and two.

And ladies and gentlemen at this time, in showing no additional questions, I'd like to turn the floor back over to management for any closing remarks.

Sameer Bharadwaj
Thank you, everyone, for joining the call. And we look forward to seeing you at the end of Q3.

Operator
And ladies and gentlemen, with that, we'll conclude today's conference call and presentation. We thank you for joining. You may now disconnect your lines.