THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GNTX - Q2 2018 Gentex Corp Earnings Call

EVENT DATE/TIME: JULY 20, 2018 / 1:30PM GMT

CORPORATE PARTICIPANTS

Josh O'Berski

Kevin C. Nash *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Neil Boehm *Gentex Corporation - CTO & VP of Engineering*

Steven R. Downing *Gentex Corporation - President & CEO*

CONFERENCE CALL PARTICIPANTS

Anthony J. Deem *Longbow Research LLC - Senior Analyst*

Christopher Ralph Van Horn *B. Riley FBR, Inc., Research Division - Analyst*

David Michael Stratton *Great Lakes Review - Research Analyst*

David Whiston *Morningstar Inc., Research Division - Strategist*

John Joseph Murphy *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Joseph D. Vruwink *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Richard Clayton Carlson *BMO Capital Markets Equity Research - Analyst*

Richard Michael Kwas *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gentex Second Quarter 2018 Earnings Call. (Operator Instructions) I'd now like to introduce your host for today's conference, Mr. Josh O'Berski, Director of Investor Relations. Sir, please go ahead.

Josh O'Berski

Thank you. Good morning, and welcome to the Gentex Corporation Second Quarter 2018 Earnings Release Conference Call. I'm Josh O'Berski, Gentex Director of Investor Relations. And I'm joined by Steve Downing, President and CEO; Kevin Nash, Vice President of Finance and CFO; and Neil Boehm, Vice President of Engineering and CTO.

This call is live on the Internet by way of an icon on the Gentex website at www.gentex.com. All contents of this conference call are the property of Gentex Corporation and may not be copied, published, reproduced, rebroadcast, retransmitted, transcribed or otherwise redistributed. Gentex Corporation will hold responsible and liable any party for any damages incurred by Gentex Corporation with respect to any unauthorized use of the contents of this conference call.

This conference call contains forward-looking information within the meaning of the Gentex safe harbor statement included in the Gentex Reports Second Quarter 2018 Financial Results press release from earlier this morning, and as always, shown on the Gentex website. Your participation in this conference call implies consent to these terms.

Now I will turn the call over to Steve, who will give the second quarter financial 2018 financial summary.

Steven R. Downing - *Gentex Corporation - President & CEO*

Thank you, Josh. For the second quarter of 2018, the company reported net sales of $455 million, which was an increase of 3% compared to net sales of $443.1 million in the second quarter of '17. When compared with the company's mid-April forecast for the second quarter of '18, actual light vehicle production in North America declined approximately 3%, which resulted in lower-than-expected unit shipments and revenue during the quarter.

Additionally, OEM shutdowns related to a supplier fire caused a revenue headwind of approximately 1% during the quarter. The second quarter of '18 revenue growth rate fell just outside of our guidance range for the year, which, although disappointing, is explainable when viewed in the context of production levels by region and segment.

The overall production levels in the North American market were down 3% quarter-over-quarter. And the luxury segments, defined as D and E segment vehicles, were down over 3% quarter-over-quarter in our primary markets of North America, Europe and Japan and Korea.

Our total net growth rate of 3% in a quarter where luxury segments were down 3% in our primary markets, represents an outgrowth to the underlying market of 6%. While we aren't happy with this level of growth, we remain optimistic about the second half of '18, based in part on our product launch cadence of Full Display Mirror nameplates over the balance of the year. And while we continue to monitor the production levels in our primary markets, we still believe that the second half of the year will be closer to the top end of the range of our annual guidance.

For the second quarter of '18, the gross margin improved to 38% when compared to a gross margin of 37.7% in the second quarter of '17 and from 37.1% in the first quarter of '18, primarily as a result of improved product mix and purchasing cost reductions. The gross margin improvement from the first quarter of '18 was impressive, given the lower-than-expected growth rate for the quarter and was primarily driven by product mix improvements and the team's hard work to manage cost. As we move through the second half of '18, there is still opportunity for us to show additional improvements in gross margin based on the forecasted revenue growth rates and product mix, despite the negative headwinds expected from the tariffs that took effect on July 6.

Operating expenses during the second quarter of '18 were up 12% to $46.1 million when compared to operating expenses of $41.3 million in the second quarter of '17, primarily due to increased staffing levels. Income from operations for the second quarter of '18 increased 1% to $126.7 million when compared to income from operations of $125.9 million in the second quarter of '17, primarily due to the increased quarter-over-quarter sales growth and gross profit margin percentage offset in part by increased operating expenses.

Other income increased to $2.3 million in the second quarter of '18 compared to $2.1 million in the second quarter of '17, primarily due to decreased interest expense. During the second quarter of 2018, the company's effective tax rate was 15.5%, down from 30.8% during the second quarter of '17, primarily driven by the impacts of the Tax Cuts and Jobs Act of 2017 and the tax planning initiatives undertaken by the company.

Net income for the second quarter of 2018 increased 23% to $109 million compared with net income of $88.5 million in the second quarter of '17. Earnings per diluted share in the second quarter of 2018 increased 29% to $0.40 compared with earnings per diluted share of $0.31 in the second quarter of '17 as a result of the lower effective tax rate and a reduction in diluted shares outstanding on a quarter-over-quarter basis.

During the second quarter of 2018, we repurchased 6.3 million shares of common stock at an average price of $23.33 per share, for a total repurchase of $146.6 million. For calendar year '18, we have repurchased a total of 15.6 million shares at an average price of $22.36 per share for a total of $349.2 million.

As of June 30, 2018, the company has approximately 19.7 million shares remaining available for repurchase as part of our previously announced share repurchase plan, which remains a part of our broader publicly disclosed capital allocation strategy. We intend to continue to repurchase additional shares of our common stock in the future in support of the capital allocation strategy, but share repurchases may vary from time to time and will take into account macro economic events, market trends and other factors that we deem appropriate.

During the second quarter of 2018, we paid down $26.9 million of principal on our term loan and we expect to pay all the remaining principal on our credit facility during the third quarter of 2018.

I will now hand the call over to Kevin with the second quarter 2018 financial details.

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Thank you, Steve. For the next few minutes, we'd like to spend some time discussing additional details of the second quarter, key factors that drove the second quarter results and points of consideration as we move to the remainder of '18.

Automotive net sales in the second quarter of '18 were $444.2 million, an increase of 2% compared with automotive net sales of $433.9 million in the second quarter of '17, which was aided by an 8% increase in auto-dimming mirror unit shipments on a quarter-over-quarter basis, but partially offset by certain advanced feature headwinds, primarily related to Driver Assist sales.

Other net sales in the second quarter of '18, which includes dimmable aircraft windows and fire protection products, were $10.7 million, an increase of 16% compared to other net sales of $9.2 million in the second quarter of '17. One of the main focuses of our capital allocation strategy that was established earlier this year was a reduction in our target balances for cash and investments to $525 million by the end of calendar year '18.

As of June 30 of '18, the combination of cash, short-term and (inaudible) were $609 million, down from $779.9 million as of December 31. The primary drivers for these overall reductions were also part of our capital allocation strategy, which included increased share repurchases and accelerated debt repayments in addition to capital expenditures and an increase to the company's dividend rate earlier this year.

The current mix between cash and investments may change on a quarterly basis related to changes in liquidity requirements, fluctuation in interest rates and fixed income investment maturities and reinvestments. Accounts receivable for the quarter was $239.4 million as of June 30, up from $231.1 million as of December 31, primarily due to higher sales levels on a period-over-period basis.

Inventories were $212.4 million as of June 30, down from $216.8 million as of December 31. Accounts Payable increased to $106.8 million as of June 30 from $89.9 million due to timing of certain payments. And accrued liabilities were $107.6 million as of June 30, down from $153.8 million as of December 31, primarily driven by accelerated debt repayments.

Now for a couple of cash flow highlights. For the second quarter of '18, cash flow from operations was $144.9 million compared with $132.3 million in the second quarter of '17, driven by increased net income and fluctuations in working capital. CapEx for the second quarter of '18 was $25.6 million compared with $29.1 million for the second quarter of '17. And lastly, depreciation and amortization for the second quarter of '18 was $27.9 million compared with $25.2 million in the second quarter of '17.

I will now hand the call over to Neil for a product update.

Neil Boehm - *Gentex Corporation - CTO & VP of Engineering*

Thank you, Kevin. In the second quarter of 2018, there were 17 new nameplate launches of our inside and outside electrochromic mirrors and electronic features net of previously disclosed feature headwinds. During the second quarter, approximately 60% of the net auto-dimming inside mirror launches contained advanced features. The second quarter was highlighted by increased launch levels in HomeLink and Full Display Mirror applications as well as 4 new inside auto-dimming mirror applications for domestic China OEM.

Now for a quick update on our Full Display Mirror product. In the first quarter of 2018 conference call, we discussed that our launch cadence would have us shipping Full Display Mirrors on at least 6 additional nameplates through the second half of the year. Having just crossed over the midpoint of the year, we remain confident in our product launch cadence for Full Display Mirrors in the second half of the year, and we are on pace to complete the launches necessary to achieve our target of 500,000 Full Display Mirror unit shipments in calendar year 2019. Also, we are pleased to announce that during the second quarter of 2018, we were able to secure Full Display Mirror business with our seventh OEM. The start of production for this OEM will be in the 2020, 2021 timeframe. Full Display Mirror continues to be well received by our OEM customers and we are optimistic that we will receive an additional award from an eighth OEM around the end of 2018.

Now we would like to provide an update on the sales and business development activities surrounding our Integrated Toll Module. We are pleased to announce that during the second quarter, the company has officially signed agreements with 2 additional OEMs to launch our ITM product. Both of these OEM launches are targeted to begin production shipments in the 2020, 2021 time periods.

I'll now hand the call back over to Steve for 2018 and 2019 guidance and closing remarks.

Steven R. Downing - *Gentex Corporation - President & CEO*

Thank you, Neil. Based on our mid-July vehicle production forecast, as disclosed in our press release, the company currently expects revenues in the second half of calendar year '18 to increase between 7% and 10% when compared with the second half of calendar year '17. And as a result, we have updated our revenue guidance to be between $1.88 billion and $1.91 billion for the year.

Based on our year-to-date gross margin performance, as well as taking into account recently enacted tariffs related to imports from China, we are updating our gross margin guidance for the year. We are currently estimating the impact of tariffs to be between $5 million and $8 million for the second half of '18. Based on the actual gross margins year-to-date and the impact of the tariffs, we are updating our gross margin guidance to be between 37.5% and 38.5% for calendar year '18.

We continue to monitor and evaluate the impact of these enacted tariffs along with other potential import and export tariffs that may be implemented by other countries and affect our raw materials or finished goods. We are adjusting our range of operating expenses down to be between $180 million and $185 million for calendar year '18 as a result of our year-to-date operating expenses.

Based on year-to-date capital expenditures and timing of new projects over the balance of the year, the company is lowering its capital expenditure estimates to be between $110 million and $120 million for calendar year '18. We are making no changes to our estimates for depreciation and amortization or estimated tax rate for calendar year '18.

Lastly, based on 2019 light vehicle production forecast and current forecasted product mix, the company is making no changes to its previously announced revenue estimates for calendar year '19, which continues to be estimated to be over and above our 2018 revenue estimates in the range of 5% to 10%. The first half of 2018 has been challenging, but the company continues to be focused on delivering higher growth rates and gross margin performance in the second half of this year based on our technology roadmap and Full Display Mirror launches.

Thank you for your time today, and we can now proceed to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question come from the line of Chris Van Horn with B. Riley.

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Congrats on the full display awards.

Steven R. Downing - *Gentex Corporation - President & CEO*

Thanks, Chris.

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Just first off, could you give us some details on some of the gross margin headwinds in the quarter? Was it pricing-related, was it product mix? Any additional details you could share on that?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Well, thanks, Chris. During the quarter, actually, we saw, as you recall, sequential improvements, both sequentially and on a year-over-year basis. And so really, we saw good performance out of the product mix, primarily due to some underperformance on some Driver Assist features that was buoyed by growth in our outside mirror product and some of our other advanced features. So we were pretty pleased given the lower sales growth that we were able to help offset our manufacturing costs and efficiencies with other costs and then getting a little bit better performance out of our purchase -- our PPV or our purchasing cost reduction. So we were pretty pleased given the 3% sales growth with that expansion in margin, both on a year-over-year basis and sequentially.

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes. Chris, I would just say that the single biggest headwind that we've -- that you can't offset or wasn't offset in the quarter was the one Kevin mentioned at the end. In other words, if the growth rates were higher, we would have seen a little bit more margin expansion.

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Okay, yes, that's what I was getting at. Okay, that makes sense. And then what's driving the international growth? You've seen really consistent double-digit growth there on the mirror shipment side. Is it new customers, new launches, both, more content, what's kind of driving that?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Can you ask that again, Chris?

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Oh, I'm sorry. So in the international side, the shipments continue to rise double digits. And what's driving that? Is that new customers, new nameplates, both, is it additional content as well?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Yes. Yes, sorry. It's primarily penetration rates of existing customers. So I mean, as it relates to the number of customers we have, we pretty much ship to all the major European OEMs. So there's not like a new customer per se. But what it does represent is the products being added to more vehicles and more nameplates. And then with the nameplates that we are on, higher take rates. So it's really kind of that spread of the product across much more of the population of vehicles produced in the European and Asian markets.

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Okay, got it. And then Full Display Mirror obviously tracking very well in terms of award activity. Probably can't give a lot more detail on the new awards, but is it -- these are obviously new OEMs to the platform. Is it a single program to start? Or is it multiple programs? And then how were -- how is the rollout going with the existing customers? And what's kind of been the feedback so far on that?

Neil Boehm - *Gentex Corporation - CTO & VP of Engineering*

Great question. So this is Neil. The question about the additional customers, the initial ones always start with a primary project or primary program to begin and then there will be a roll-off strategy that forms as we get closer to that timeframe. In regards to the existing customers, when we talked in the Q1 about -- I think we announced 15 nameplates -- 14 or 15 in Q1, and we're talking about at least 6 additional, that was expansion on the existing customers that we already have. So that continues to go really, really well. You'll see those starting to come out here in the next quarter. You'll see those publicly be visible and we're excited about that continuing growth through the end of the year.

Operator

Our next question come from the line of David Liker with Baird.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

This is Joe Vruwink for David. On the China tariffs, is qualifying secondary suppliers elsewhere in Asia a possibility? And if you do look to do that, is there a timeframe associated with that? I'm just wondering if the $5 million to $8 million is maybe the worst-case scenario thinking about it and things you can do over time you'd expect to actually mitigate that impact?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Well, I'd say the $5 million to $8 million is kind of the worst-case range. If -- but that's only looking at the tariffs that are enacted currently. Obviously, every day, you open the media report, there's more discussions. So I don't want to prognosticate on what the future holds as it relates to tariffs. As it relates to our ability to offset those, the first possibility is that many of our suppliers have locations in multiple countries in Asia. And so our preference would be to stick with our current supply base and hopefully find different sources of -- different countries that they can source those products out of and produce those out of to hopefully avoid some of those. That does take time. The kind of the second plan would be obviously to find either new suppliers that could produce in different areas where -- that aren't subject to the tariffs. That validation is quite longer. They're talking about it pretty significantly. Remember, every product that we build is -- every sub-supplier is approved and then that product gets validated as the final finished good. And so to change your sub-supplier means you had to redo that validation process. So that would take a lot longer. You're looking at probably typically a 12- to 18-month process and quite a bit of expense to make that happen. It's not impossible. And if it makes sense, we would look at it. But our preference is, obviously, to try other creative ways around those as much as possible.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

And then the $5 million to $8 million, so that's really kind of a gross impact. And thinking about your product, you're an option product that your customers mark up and make a lot of money on. So do you have the ability, do you think of over time, to reprice out of your customers understanding there's inflation here? And so the net from just pricing could offset those?

Steven R. Downing - *Gentex Corporation - President & CEO*

Well, it will be interesting. The industry hasn't really addressed that question yet. So the tariffs just took effect. So it will be interesting to see how the supply base as a whole addresses this with OEMs as it relates to the cost increase to all the products. So it's difficult to say at this early stage how much tolerance OEMs will have towards price changes related to tariff structure.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Okay. And then on the industry dynamics and calling out the segment underperformance. So this has been going on a while now. And in this quarter, it actually looks to have gotten worse globally, production accelerated quarter-over-quarter. So is there anything on the horizon, either industry-wise, customers on the D, E segment just have more new product launchings so you'd expect some market share benefit? Or maybe Gentex's own program launches are going to lower exposure to D and E over time? Anything there you would call out to say that, while it's been a headwind, the headwind should lessen? Or does the outlook into the second half essentially assume that D, E segment performance isn't getting any better?

Steven R. Downing - *Gentex Corporation - President & CEO*

Well, I think if you look at the forecast, I mean, the Q3 in particular, I mean, and North America strengthens quite a bit, even in those segments. So as we look forward, we don't see this necessarily being a trend that continues where D and E continues to underperform in the market. We think it will stabilize at some point. The other part about this is that as a lot of OEMs start to focus on more crossover-type vehicles versus traditional sedans, historically, that's represented a positive kind of vehicle line up for us in our products. So we're still optimistic that if you look at where production is heading, if you look at the macro trends, it doesn't seem to show that production itself is declining significantly. Then we think that mix -- our product mix, including our Full Display Mirror launches, will help position us very well to continue to grow in this production environment.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

And then my last question. On Q3, and really the second half, with WLTP going into effect in Europe, some of your European customers have called out just needing more time to produce the same number of vehicles. And so you'd expect some inefficiencies and Q3 impacts on production. Have you factored that in? So IHS obviously has a forecast that you're getting customer call-offs. Is that anticipated in the second half views you're providing?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, between the incoming forecast that we use from our forecasting suppliers and then our own analysis and then also the call-offs from OEMs for the next quarter, so we look at all those inputs to drive our forecast. And right now, we don't see that being a significant impact to our forecast in Q3.

Operator

Our next question comes from Rich Kwas with Wells Fargo Securities.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Just following up on that last point. So you -- we shouldn't think of the balance of the year, meaning Q3, Q4, it should reflect normal seasonality largely speaking, revenue-wise?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, yes.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

All right. So these impacts in Europe, et cetera, not enough to move the needle against normal seasonality in your view at this point?

Steven R. Downing - *Gentex Corporation - President & CEO*

Correct. And really, what you'd see is there is a -- there may be a modest impact to that from more than normal seasonality, but that's more than offset by our production launches, Full Display Mirror launches and other product launches. And so that growth rate accelerating in the second half is what we're seeing.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Then you're probably getting some lift from -- post the Meridian Fire, right, in Q3?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, that was like about a 1% headwind in Q2, though. And honestly, like -- at these production levels, it's tougher than they catch up that lost production time. But you would expect a modest tailwind in Q3 from that.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay. All right. And then on the tariffs, the $200 billion that's being contemplated, where they put 10% on, they can't...

Steven R. Downing - *Gentex Corporation - President & CEO*

Or the $500 billion from this morning?

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Yes, it's a pretty fluid topic these days. But I mean, with the $200 billion, though, let's just -- we can't really, I think, put any numbers around -- I mean, figure out what -- obviously, the President said something this morning. But I mean, the $200 billion has been out there for a few weeks now. What -- how should we think about that potential incremental impact? I mean, I imagine it's probably fairly limited for '18. But what will be your exposure on a gross basis? Any kind of estimate we can think about particularly as we think about '19?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Yes, our supply chain team does not like Steve or I right now. So (inaudible) with that because they've been crunching the numbers over the last couple of weeks as these -- I think it covers about 6,000 ACS codes, which we are inside of. And right now, our estimate is pretty broad and we don't have all the numbers. But it's probably, on an annual basis, call it, $5 million to $10 million, depending on again where we source if we can resource stuff out of a different country other than China. But it's somewhere in that range, potentially higher once we quantify all that. But again, that's not enacted yet. And like Steve said, at this moment, they want to have tariffs on all $500 billion coming in. So I think -- that's what we've done (inaudible), but it may change.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Yes, sure. Sure.

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

But it's not -- it's definitely not too impactful but it certainly is something we're working on and looking at and trying to figure out a way through.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

All right. So it's $5 million to $8 million for the balance of this year. Then you get -- related to the first [34], would you get another $5 million to $8 million, right, for the first half of next year because it's half of the year?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Yes, yes. Yes, exactly. That's -- you have to annualize that $5 million to $8 million for '19.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

And then there -- and then on top of that, if this goes into effect, it would be $5 million to $8 million on an annual basis?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Correct.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Okay. All right. Got you.

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Additional.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Okay then just in terms of the your proposed Section B, Annex B of the European tariffs, so that would go into effect in '21? I mean, does that have -- obviously, it doesn't have any impact in the near term. But how do we think about the ability to -- from a quoting standpoint, where you go to market, you're bidding, you got your cost structure in place, everything is done here. How do we think about potential being at a disadvantage versus some of your key competition that would have manufacturing capacity in Europe?

Steven R. Downing - *Gentex Corporation - President & CEO*

Well, it's someone that's just starting to play out. Obviously, the European side has a longer horizon. So we believe there's a lot more changes that could come over the next, say, 18 months to 2 years that could impact that. But it is something that we're going to be looking at and talking with our OEM customers about as we move forward, that if this becomes very prohibitive to doing business, we're going to have to get creative with solutions around how we can make sure our costs get to those customers in a cost-effective way that doesn't change our take rates.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Right. Okay. I mean, it's just something to think about as you guys start to bid stuff out for '21 and beyond.

Steven R. Downing - *Gentex Corporation - President & CEO*

Right. Absolutely.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Lastly, just buybacks. It was elevated versus what you were kind of targeting, I think, at least, publicly around $100 million a quarter or so. Just how should we think about the second half of the year?

Steven R. Downing - *Gentex Corporation - President & CEO*

Well, remember, the first half -- the first quarter was actually a little lower if you take out the one-time repurchase at the beginning of the quarter from Fed shares. Then you look at Q1 was actually below the $100 million, I would think it's in the mid 80s. And so we were playing a little bit of catch-up from Q1, and then the other part of it was just being situational. Some of the numbers, we believe, were very favorable, has a repurchase price. So we picked up that pace a little bit at the end of the quarter.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay. But the $425 million is still the target for the year?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Roughly. Remember, the primary target is the net cash position at the end of the year. And so that's what we're focused on, on December 31, being around that $525 million in cash and short and long-term investments. And so on the difference there and what the gas pedal gets pressed if cash generation accelerates, we'll probably be a little bit more aggressive on the repurchase side.

Operator

Our next question come from Anthony Deem with Longbow Research.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Just wanted to dig into a near-term issue, then some long-term stuff. So on the second quarter revenue miss, is that -- so Driver Assist seems to be the culprit. Was that related to the Mobileye rolling off or this greater-than-expected Smart -- weakness in SmartBeam in general? Can you just expand on that comment?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, it was really both. If you look at a couple of factors, one of them was the Mobileye -- the beginning of the Mobileye roll-off. The other factor was the Meridian fire impacted Ford pretty significantly. And so all of our Driver Assist business is with Ford currently. And so that did impact the Driver Assist orders -- the Mobileye Driver Assist orders in the quarter. And then the SmartBeam -- some of the SmartBeam headwinds that we've been discussing the last few quarters were part of that as well.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Got it. And then weaker-than-expected shipments, they're still up 8%, which was pretty strong. So I would assume the supplier plant fire was around 100 basis points. So was the expectation around 9%? Or was it weaker production, maybe another couple of 100 basis points on top of that? So maybe the expectation going into the quarter was low double digits or something along those lines?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, absolutely. We are looking at low double digits kind of on a unit growth basis going in and we are also on the top line side, in terms of dollars, we are expecting that to be more in the 5% to 6% range. So the fire was about 100 basis points, and then we believe there's another couple of hundred points of, like we mentioned, the customer orders changes in the quarter for the quarter and primarily driven by D and E segment production and the North American market being a little below what everyone was predicting for the quarter.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Got it. And I had 2 questions on the product wins, on ITM and FDM. So on ITM, it's great. So up to 3 OEMs, I believe. You had 1 win before, if I'm not mistaken. I'm just wondering, with the 2 announced today, are those mass market or more German OEMs? Can you help expand on who the customers might be?

Neil Boehm - *Gentex Corporation - CTO & VP of Engineering*

Yes, they're -- so yes, you're right. We do have 3 now. One goes to production late this year, and the other 2 are more luxury side vehicles -- luxury brand vehicles.

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Okay. And then on FDM, so you're optimistic you can win another OEM by late this year? Is that going to be on the Gen 2 FDM? Or you're still bidding the Gen 1 there?

Neil Boehm - *Gentex Corporation - CTO & VP of Engineering*

That would be on the Gen 2.

Christopher Ralph Van Horn - *B. Riley FBR, Inc., Research Division - Analyst*

Okay. Okay. And then just lastly, so thinking about Gentex long term, is it a fair statement if I said the potential Level 5 offerings today are focused exclusively on connected car and maybe dimmable cabin features as opposed to vision solutions? Is that going to be the case longer term? Or is there a team plan to compete to be a provider of -- like vision technologies that might actually de-content the exterior and interior mirrors as a backup safety device? I mean, you see the new Mitsubishi product being talked about this year in Japan that's available next year that seems. I know Gentex is an in-house -- has an in-house developed imager today, I think, with FDM. So is this technology applicable to future innovations? And can you just expand on any additional OEM Level 5 vision offerings?

Steven R. Downing - *Gentex Corporation - President & CEO*

Sure. If you look at our Full Display Mirror, we believe that's the leverage point to introduce a full camera monitoring system in the vehicle. So that's what we're showing at CES the last 2 years as models that -- vehicles that we prototype that show how smaller mirrors in combination with cameras and displays can be used as a supplemental vision system. What we tend to take a strong point on, though, is that in order to guarantee safety, that redundancy is incredibly important. We believe most OEMs have reached a very similar conclusion that in theory of completely digital solution, if possible, in practice, it's very hard to pull off and it's very difficult to convince consumers that 100% of people will like that type of technology. Our experience says that many people enjoy digital displays, some do not. And so what we're offering is a combination of our hybrid solution that does all of the above. We continue to believe it's best-in-class from a safety and reliability, dependability standpoint. So yes, we absolutely intend to continue to be a supplier of cameras and vision systems and displays to help bring about that kind of autonomous car of the future.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Okay. If I can fit one more in here, and I appreciate the time. Can you give us an update on maybe the digital rear and side vision systems and the -- your product's role in Level 3, Level 4 autonomous. At CES, when I visited you guys, I was under the impression that the CMS technology was production-ready, no longer proof-of-concept. So just wondering here if we're still on the development phase or if you're in RFQs with CMS.

Neil Boehm - *Gentex Corporation - CTO & VP of Engineering*

Yes, Anthony. It's still in the development stage, proof-of-concept stage with customers. So because of the change in the combination of mirrors with cameras, as Steve was just talking about, we're still in that kind of business development process of selling a product and working with customers on how it can fit into the strategy going forward. So there is no RFQs at this stage yet. We are working through that process with a couple different customers. And hopefully, we'll have a better update in the future on the progress of that.

Steven R. Downing - *Gentex Corporation - President & CEO*

And it's important to remember, most OEMs haven't made clear decisions yet on what direction they're going to take as it relates to this type of technology. So this is still very early in the decision-making phase for most OEMs. The vehicles that you referenced typically are low-volume applications and unique applications by an OEM to kind of beta-test this in a very unique market, and so we keep an eye on that. We participated in some of those in the past. But what we're really focused on now is our actual volume production program, trying to find one that makes sense for an OEM.

Operator

Our next question comes from John Murphy with Bank of America Merrill Lynch.

John Joseph Murphy - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

First question on the trade stuff. I mean, this is sort of a new world order for a lot of us. I mean, I've been looking at the industry for 20 years and this is all kind of new. So it's tough for us to all figure out. When you look at what's going on with the proposed tariffs in Europe, I mean, is the timeline really 2021? Or is there the risk that it gets pulled forward or changed? I mean, what have you heard on that? And it's kind of weird that they kind of are shooting at rearview mirrors. It's a weird product for them to pick out. Just curious why you think that happened.

Steven R. Downing - *Gentex Corporation - President & CEO*

It's always -- it's fascinating to watch how things develop. There's a lot of items covered in those categories. So I think it's probably more looking at generic kind of big picture areas and looking at probably industries and then trying to find ways to put a tariff or duty in place that makes sense. In terms of prognosticating about pull-aheads, I wouldn't go so far as to try to guess how that's going to happen. What we do know is, right now, the EU has been pretty good about when they give a timeline, probably holding to it. It doesn't mean it couldn't amp up and change. But right now, our plans are around what we know to be true and that is -- that's the timeline we're working with. So we're hoping, obviously, that this settles out and becomes some type of a negotiated settlement that makes sense. If not, we're going to be prepared to do what we need to, to keep the business moving forward.

John Joseph Murphy - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

And I guess there's 2 responses. I mean, working with your -- I mean, presuming this goes through, working with your customers to try to pass this through and make yourselves whole or potentially open up a facility over in Europe. I mean, I know you guys have been very tight in dealing with Michigan which seems to have made a lot of sense so far the way world has normally worked, but it's changing. I mean, is that something that you would consider 3, 5 years down the line if it made sense?

Steven R. Downing - *Gentex Corporation - President & CEO*

Well, like I mentioned before, I mean, we're going to do what we need to, to keep the business moving forward. So we're not -- every day we will come into work. Obviously, we have to assume that there are no sacred cows and you have to be willing to look at every situation differently. And if this were to negatively impact our ability to grow or that actually start hurting sales, of course, we would have to consider alternatives. We're still hopeful that this shakes out in a more reasonable fashion and that our current business model can work because that's the one we feel more comfortable with and most confident in and we believe has produced the most return for shareholders. But that being said, if something changes, of course, we'll be willing to do what we need to.

John Joseph Murphy - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Okay. And then just a last question on quoting activity and kind of following up on where cost was going before. Have you seen any change in quoting activity in response to this? But then also sort of all the other uncertainties that are kind of popping up in the world right now where you're seeing maybe some of your customers hit pause on your incremental capital investments and maybe things have slowed down a little bit? Or is it really just business as usual and you're not seeing any change in -- sort of any marked change in sort of RFPs and all that kind of stuff?

Steven R. Downing - *Gentex Corporation - President & CEO*

No, I don't think you would ever see a change in RFPs or quote process because of this. What you would tend to see, the most logical reaction would be the OEMs are going to drive the product strategy that they believe in. How it would typically impact you is once you get to that time period, it would probably be more likely to impact take rates than it would sourcing off a product. In other words, instead of -- if this were to happen and it was worst-case scenario, instead of a 30% or 40% take rate on a product, you might be looking at a 10% take rate because obviously their business case changes and then it's only -- they're only going to get paid X from their customers so they would be looking to find that maximum profitability for themselves. So I don't think you would ever see an OEM say, "Hey, we're going to stop looking at new technology and focus on a 3-year out product launch." It would be more about how good of a take rate can you get, what do the packaging options look like and what's the total maximum upside business for us if this plays out in the worst-case.

John Joseph Murphy - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Okay, I'm sorry, just one last question on raws. I mean, you have given -- we're seeing inflation in raw material cost and then you're having this increase in some of the stuff you're purchasing from China. I'm just curious how your contracts work with either pass-throughs or indexing? And are they different for just market dynamics versus what might happen sort of with the tariff? I mean, is there any kind of line of demarcation in these contracts? Or would it just be a general inflation number that you could pass or index?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes. Well, I mean on the tariff side, it's going to be interesting to see how the industry as a whole and our customers react to many suppliers who are going to struggle with this and to see how -- what the responses from OEMs to this cost increase that a lot of suppliers are going to experience. So that one is still yet to play out. I assume that I'll be playing out fairly quickly here in the next several months and quarters. In terms of indexing, there's really not a whole lot you can do. Now in theory, what the tariff is designed to do is obviously create additional supply base in other alternative markets. So in theory, over the long run, if this worked, that you would see suppliers put plans up in different geographies that would be able to avoid the tariff. That does take time, however. And so we're kind of working with our suppliers right now and completely understanding where their footprint is on their geography to see if there's better ways to accomplish the receipt of those products at a favorable price.

John Joseph Murphy - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Any chance those can (inaudible) to the U.S. because that's kind of the purpose here, right? I mean...

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, I think on a lot of the products, that's possible on the -- on anything silicon-based. I mean, that's where the difficulty comes, right? electronics, especially in these foundries and plants, are incredibly large, very complex. Even if someone made that commitment to want to do them, you're talking about regulation issues and then also tremendous amount of capital investment and physical size. So you're probably looking at 3 to 5 years before something like that would be a foundry basically would be able to exist in the U.S. and producing parts. Because I mean, not only do you have to get that foundry up and running, you then have to go through the whole validation, the process in the plant, and then obviously, all the suppliers have to go through a full OEM approval of that new product.

Operator

Our next question comes from David Stratton with Great Lakes Review.

David Michael Stratton - *Great Lakes Review - Research Analyst*

I think you touched on it fairly well before. I just want to make sure I got my head wrapped around it correctly. And that's regarding the issue with the supplier. It was a 1% headwind now, but you expect a tailwind going forward. But then you kind of hedged with -- they were going to have trouble catching up in general. So looking into the second half of the year, do you see that being a continued headwind? Or does that just kind of melt away here? How should I think about that?

Steven R. Downing - *Gentex Corporation - President & CEO*

Sure. That wasn't our supplier, that was actually the Meridian fire that kind of took down the several OEMs for a couple of weeks based off some line downs. So the problem with the OEMs catching up to that as they were running near full capacity already. So once you lose a couple of weeks out of a production schedule, it's hard to add back that couple of weeks into it when you're already running at near capacity level. So that's the issue. So we would expect a little bit of a tailwind, but probably not the full 100-basis-point tailwind all in Q3 just because of capacity constraints by those OEMs.

David Michael Stratton - *Great Lakes Review - Research Analyst*

All right. And then in the prepared remarks, you mentioned a lot of the sequential margin improvement was from cost management. And I was just wondering if there was anything that you'd like to highlight there? Or is that just overall everybody doing little bit? Or is there a single cost initiative that is taking shape and helping out?

Steven R. Downing - *Gentex Corporation - President & CEO*

No. I mean, I think we have quarterly updates with our team and everybody knows kind of the goal. There's a big focus on manufacturing costs all the time, but we did see some improvements in our variable manufacturing costs which helped to offset our inefficiencies on the fixed side. So our fixed capital investment was offset by, call it, improved scrap rates and a little bit better efficiency on the labor side. So it's really just everybody doing what we already do, but a little bit better.

Operator

(Operator Instructions) Our next question comes from the line of David Whiston with MorningStar.

David Whiston - *Morningstar Inc., Research Division - Strategist*

Wanted to follow-up on one of John's questions on tariffs. Are you -- it sounds like you're not hearing any kind of difference in the level of concern from, say, the German OEMs versus the Japanese, Korean or American OEMs. Is that fair?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes -- on the tariff side?

David Whiston - *Morningstar Inc., Research Division - Strategist*

Right.

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes. I'd say everyone is kind of equally concerned as it relates to how -- especially also on how we manufacture that's primarily based in West Michigan and importing parts from all over the world to produce our product. So I think it's probably different for each supplier in terms of where they're getting pressured based off their geographical bias.

David Whiston - *Morningstar Inc., Research Division - Strategist*

Okay. And if there's more tariff headwinds or the U.S. does enter a recession, your various capital spending and your expansion products -- projects, would you -- if it was right in the middle of a project, would you keep going or would you freeze those temporarily?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Well, it depends on what kind of product it is. So if you're halfway done building a building, you probably have to finish. If it's something else, then there's different ways you can hit pause. I -- it's hard to imagine something right now like catching us mid-cycle where we would have to make a decision like that. We're pretty careful about how we do things, and we have gate processes for all of our capital expenditures. So if something were to happen, it wouldn't be abnormal for us to hit pause at a gate and push out or wait until the timing was right. So that wouldn't be the first time in the company's history that happened. I mean, we do that on a regular basis and that's part of our normal CapEx processes, the discipline necessary to make sure the right things are happening and everything is executing the plan before we finish.

David Whiston - *Morningstar Inc., Research Division - Strategist*

And in the press release, you called out increased staffing levels. Is that mostly in line? Is it in engineering, sales?

Steven R. Downing - *Gentex Corporation - President & CEO*

Yes, it's a combination of engineering, so contract engineering for a lot of the launches that we're working on. A little bit of -- in the SG&A area, we talked about increased levels there to help with our business development process and some new markets that we're working into. So it's a combination of staffing levels across. It's kind of the engineering and selling organization.

Operator

Our next question comes from Richard Carlson with the BMO Capital Markets.

Richard Clayton Carlson - *BMO Capital Markets Equity Research - Analyst*

So pretty much all the questions have been answered so far. But I just want to maybe clarify on the $525 million in net cash target in the $425 million of planned share buybacks this year. So you're already below that net cash target now mid-year. So obviously, of course, for typical cadence expect some pretty good cash flow in the back year. But I guess how rigid are you with that $525 million? And what does that tell us about any kind of M&A plans? I mean, if something came along, is that why the $525 million is being kind of -- being protected so that you can do that? And what's the comfort level of the leverage in case something did come up?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

Yes, exactly. So one of the things we're doing as part of that capital allocation strategy, we're working through some loan documents right now. We're going to be opening up -- as we pay off the debt from the HomeLink acquisition, we're going to be opening up a new [LSE] through the remainder of this year to help us prepare for potential M&A. Technically, we're at -- we're actually above that target. We're about $609 million right now, cash short-term and long-term investments. Those are all liquid investments. So we can turn those into cash anytime we want basically. One of the things that we're focused on there is kind of getting from that $609 million point now down to about the $525 million. The $525 million isn't like a rigid number. In an essence, if an M&A opportunity came up, obviously we put the capital allocation strategy on hold to execute this -- the acquisition or the merger, whatever became appropriate. So it's not -- that's not the hard and fast rule. We're saying if in the absence of an M&A play or something more strategic, that's the capital allocation strategy that we're going to work towards.

Richard Clayton Carlson - *BMO Capital Markets Equity Research - Analyst*

Got it. And then on the FDM, I think IHS is now kind of projecting some long-term targets for that. How do you -- how's the competitive landscape? And how are you guys forecasting kind of longer term your market share?

Kevin C. Nash - *Gentex Corporation - VP of Finance, CFO, Treasurer & CAO*

So far, we have -- we've been quoting against others -- typical competitors, Magnas in the space. I just did do their forecast sometime ago, and they -- it was an input for many suppliers. And we feel pretty good about our 500,000 unit forecast for calendar '19. And like Neil said, we've got 7 OEMs. In the [half-year], we've got -- we're working on closing number 8. And we're actively working on some others. So we're -- we feel really good about the growth prospects, both what we've already announced and then -- and that 2020, 2021 and beyond timeframe and we continue to work to further that technology from Gen 1 to now Gen 2 and then beyond. So we -- that's how we always stay ahead of our competition or try to is with technology evolution.

Operator

And I'm showing no further questions in queue at this time. I'd like to turn the call back to Mr. O'Berski for closing remarks.

Josh O'Berski

Thank you, everyone, for your time and attendance. Just as a reminder, we will be in New York at the NASDAQ MarketSite building on August 22 for our Analyst and Investor Day. So if anyone is interested in attending, please reach out and let me know. This concludes our call. Thank you, everyone.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone, have a great day.