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GNTX.OQ - Q2 2020 Gentex Corp Earnings Call

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OVERVIEW:

Co. reported 2Q20 net sales of $229.9m and net loss of $2.4m and $0.01 loss per diluted share. Expects 2H20 net sales to be $865-915m.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to today's conference call, Gentex Reports Second Quarter 2020 Financial Results. (Operator Instructions)

I'd now like to hand the conference over to your host today, Mr. Josh O'Berski, Director of Investor Relations. Please go ahead, sir.

Josh O'Berski - *Gentex Corporation - Director of IR*

Thank you. Good morning, and welcome to the Gentex Corporation Second Quarter 2020 Earnings Release Conference Call. I'm Josh O'Berski, Gentex's Director of Investor Relations; and I'm joined today by Steve Downing, President and CEO; Neil Boehm, Vice President of Engineering and CTO; and Kevin Nash, Vice President of Finance and CFO.

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This conference call contains forward-looking information within the meaning of the Gentex safe harbor statement included in the Gentex reports second quarter 2020 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.

Before we begin the formal portion of the call, we want to recognize the passing of our analyst, David Leiker from Baird. David Leiker covered Gentex for over 20 years and had a thorough understanding of our products, the uniqueness of our company and an in-depth knowledge of the automotive industry. But beyond that, David was a kind, thoughtful man who is dedicated to his family and community. His humor and friendship will be greatly missed by our team. We would like to express our condolences to his wife, Ann, and their boys and to all of his friends and coworkers on the Baird team.

Now I'll turn the call over to Steve Downing, who will get us started today. Steve?

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

Thank you, Josh. For the second quarter of 2020, the company reported net sales of $229.9 million, which was a decline of 51% compared to net sales of $468.7 million in the second quarter of 2019. The impact of the COVID-19 pandemic created extended shutdowns in the automotive industry for much of the quarter in various parts of Asia, Europe and North America. Global light vehicle production ended the second quarter of 2020, down 45% when compared to the second quarter of 2019. However, the majority of the light vehicle production declines occurred in Europe, which experienced a 62% quarter-over-quarter reduction and in North America, which experienced a 69% quarter-over-quarter reduction.

The impact of COVID-19, government-enacted shutdowns of certain countries and states and the resultant economic impact led to the most severe change in demand in a very short period of time that Gentex has ever experienced. In fact, our forecast in early March for the second quarter of 2020 was estimating a 6% growth rate. A deeper dive into the production environment provides compelling information about what happened in the quarter. For instance, the China market expanded by 9% in the second quarter. However, our historical revenue from China has been less than 10% of sales. So this provided very little help in offsetting the reductions in our primary markets. The company's primary markets include North America, Europe, Japan and Korea. And together, these regions were down approximately 59% for the second quarter of 2020. While these production numbers are incredibly sobering, the silver lining is that we are continuing to find ways to significantly outperform our primary underlying markets.

For the second quarter of 2020, the gross margin was 19.1% compared to a gross margin of 37.7% for the second quarter of 2019. Gross margin declined on a quarter-over-quarter basis as a result of the lost sales, manufacturing inefficiencies due to the pandemic and the related shutdowns, severance-related costs of $3.9 million and annual customer price reductions. When adjusted for the expenses related to severance, the adjusted gross margin for the quarter was 20.8%.

Operating expenses during the second quarter of 2020 increased by 4% to $50.7 million, which included severance-related costs of $4.9 million. This compared to operating expenses of $48.6 million in the second quarter of 2019. Adjusted operating expenses in the second quarter of 2020 were down 6% when compared with operating expenses in the second quarter of 2019, which was driven by reductions in wages and discretionary spending.

The company had a net loss from operations of $6.7 million for the second quarter of 2020 as compared to income from operations of $127.9 million for the second quarter of 2019. The quarter-over-quarter reduction in operating income was primarily the result of the lost sales due to the COVID-19 pandemic and the impact this had on gross margins in the second quarter.

Adjusted operating income was $2.1 million for the second quarter, which reflected adjustments for the impact of severance-related costs of $8.8 million in the quarter, of which $3.9 million were in cost of goods sold-related areas and $4.9 million were in operating expense-related areas.

During the second quarter of 2020, the company recognized a tax benefit of $1.5 million compared to a tax expense of $21.3 million during the second quarter of 2019. The company reported a net loss of $2.4 million for the second quarter of 2020 and a loss per diluted share of $0.01, which compared to net income of $109 million and earnings per diluted share of $0.42 for the second quarter of 2019.

The reductions in net income and earnings per diluted share were driven by the lost sales due to the COVID-19 pandemic and the resultant change in profitability in the second quarter. Adjusted net income was $4.6 million during the second quarter of 2020, and adjusted earnings per diluted share were $0.02 per share for the second quarter of 2020 when removing the impact of the severance-related costs.

The company did not repurchase any common stock during the quarter as we focused our efforts on preservation of capital, given the unknown impact of COVID-19 pandemic on our customers and the resultant impact on the company's operations and financial results. Provided that business begins to return to more normalized levels, the company will consider the appropriateness of any share repurchases in the second half of 2020. This determination will take into account macroeconomic issues, market trends and other factors that the company deems appropriate. As of June 30, 2020, the company has 13 million shares remaining available for repurchase under the previously announced share repurchase plan.

I will now hand the call over to Kevin for some further financial details.

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

Thank you, Steve. Automotive net sales in the second quarter were $222.1 million compared with automotive net sales of $456.6 million in the second quarter of 2019. The 51% quarter-over-quarter decrease in automotive sales was driven by a 51% quarter-over-quarter decrease in interior auto-dimming mirror unit shipments as a result of the overall 45% decrease in global light vehicle production and more severe decreases in Europe and North America stemming from the COVID-19 pandemic.

Other net sales in the second quarter of 2020, which includes dimmable aircraft windows and fire protection products, were $7.9 million, a decrease of 35% compared to other net sales of $12.1 million in the second quarter of 2019.

A balance sheet update. In terms of the balance sheet, the company maintained its very strong liquidity position despite the 51% reduction in sales and corresponding reduction in cash flows. I'll highlight a few key balance sheet items as of June 30 as compared to December 31 of '19. Cash and cash equivalents increased to $343.8 million, up from $296.3 million, primarily due to year-to-date cash flow from operations, investment maturities and proceeds from the $75 million draw on line of credit in the first quarter of 2020. Short-term investments were $70 million, down from $140.4 million. The company had approximately $70 million of investment maturities during the second quarter of 2020. Long-term investments were $171.8 million, up from $139.9 million. Long-term investments include FDIC-insured CDs, treasury notes as well as corporate and municipal debt.

The portfolio continues to be well positioned with over 90% of the corporate and municipal holdings invested in A-rated or better institutions. Accounts receivable declined to $170.6 million from $235.4 million. The reduction in AR was due to the significant reduction in sales during the second quarter. As of June 30, all of the company's Tier 1 and OEM customers continue to be in good standing. Inventories were $259.7 million, up from $248.9 million, primarily as a result of increased raw material inventory. Throughout 2020, our purchasing and supply chain teams have had to manage through supply chain stresses, which have included managing rolling shutdowns in our supply base, managing runoff situations on certain components and then working through the second quarter order reductions, and now, preparing for a ramp-up in the second half of the year.

Accounts payable decreased to $60.1 million, down from $97.6 million based on lower purchases from suppliers in the quarter, lower levels of capital expenditures and less discretionary spending during the quarter. And accrued liabilities were $157.4 million, up from $74.3 million. The increase was due to the $75 million draw on the company's line of credit in the first quarter of 2020.

The cash flow statement. The second quarter 2020 cash flow from operations was $39.2 million, which was down from $139.6 million in the second quarter of 2019. The company was able to continue to drive significant positive cash flow from operations despite the 51% reduction in revenue on a quarter-over-quarter basis. Year-to-date cash flow from operations was $190.5 million, which compared with $273.5 million for year-to-date cash flow from operations for '19.

Capital expenditures for the second quarter were $13.2 million compared with $28.7 million for the second quarter of '19, and year-to-date capital expenditures were $28.8 million compared to $45.5 million in '19. And depreciation and amortization for the second quarter of 2020 was $27.1 million compared with $25.2 million in the second quarter of '19, and year-to-date depreciation and amortization was $53.4 million when compared to $53.3 million in year-to-date '19.

I'll 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 2020, there were 33 total launches of our interior and exterior auto-dimming mirrors and electronic features. Of these new launches, over 60% contained advanced features. As with the previous quarter, HomeLink and Full Display Mirror led the way for the advanced feature launches. During the second quarter of 2020, the company launched 8 new nameplates with Full Display Mirror. We are currently shipping on 46 vehicle nameplates for this exciting product.

The 8 new nameplates continue to drive penetration into new segments and vehicle types. The launches during the quarter are as follows: the Buick Encore GX, the Chevy Tahoe and Suburban, the GMC Acadia, Yukon and Yukon XL as well as the Toyota Highlander and the Toyota Harrier. The Full Display Mirror for the Toyota Harrier is the first FDM to launch with digital video recording capability. This mirror system has launched in the Japan market and combines the superior functionality of the FDM with the added capability to record video from the road-facing and forward-facing cameras simultaneously. Per OEM request, the data is stored to an SD storage card.

Our integrated solution provides customers and consumers with the features they want, while allowing the OEM to control the integration and execution in the vehicle. During CES 2020, the DVR mirror was one of the future products that we showcased in our booth, and we're excited to now have it in volume production.

For the second half of 2020, we're forecasting approximately 8 new vehicle nameplate launches for Full Display Mirror. Even with the unique market situation we're all been facing, it's clear that our OEM customers and consumers value the benefits that a Full Display Mirror system provides to enhance road visibility and driver safety.

Our last product update for today is about the Integrated Toll Module. Currently, we are shipping ITM on 3 nameplates in the Audi lineup: the e-tron, the e-tron Sportback and the Q7. In late June of 2020, Audi did a press release on the 2021 Audi Q5 in which they introduced, it will also implement ITM as well. We continue to see positive momentum with this technology, and we are optimistic that it will continue to roll out over the coming years.

As we look to the second half of the year, we realize that many of our customers' expected launch timing of new vehicles may be affected by the pandemic. However, we remain optimistic because we continue to see strong demand for our latest products like FDM and ITM and some of the other products that have shown at CES.

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

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

Thanks, Neil. The company's current forecast for light vehicle production for the second half and full year of 2020 is based on the mid-July 2020 IHS market forecast for light vehicle production in North America, Europe, Japan, Korea and China.

Based on this information, light vehicle production in the company's primary regions are expected to decline approximately 7% for the second half of 2020 and 20% for the full year when compared to the same periods in 2019. Based on this light vehicle production forecast and the structural changes that the company has made over the last several months, the company is providing guidance estimates for the second half of 2020 as opposed to only updating full year guidance. Given the magnitude of changes this year, we believe this is a more accurate representation of our new cost structure and financial performance, not only for the remainder of 2020, but it should also provide more visibility as we head into 2021.

Our current estimate is that net sales for the second half of 2020 will be between $865 million and $915 million. Based on these sales levels, our updated cost structure and currently-forecasted product mix for the second half of 2020, we are currently forecasting a gross margin in the 36% to 37% range for the second half of the year.

In a normal environment, gross margins are highly dependent upon product mix, our ability to leverage overhead costs and purchasing cost reductions to help offset annual customer price reductions. In 2020, we are also dealing with a significantly smaller vehicle production environment that is resulting in sales being slightly lower in the second half of the year versus 2019.

Historically, sales declines have resulted in gross margin contraction for the company. However, given our cost control initiatives, we believe we will be able to offset the majority of the headwinds from the lower sales levels. Operating expenses for the second half of 2020 are expected to be between $88 million and $93 million. This represents a significant reduction from the annual operating expense estimates that the company began the year with and was provided in our January 2020 earnings call.

The tax rate estimate is increasing to be between 17% and 19% for the second half of 2020. Fluctuations in the FDII, which is driven by regional sales mix, and changes in discrete tax benefits are the primary drivers for the estimated increases.

Capital expenditures for the second half of 2020 are estimated to be between $30 million and $40 million. This CapEx run rate for the second half is in line with our updated annual guidance for the year of $60 million to $70 million and represents a reduction of $25 million in capital expenditures from our initial capital expenditure plan from the January 2020 earnings call. Lastly, we expect depreciation and amortization for the second half of 2020 to be between $52 million and $55 million.

Based on uncertainty regarding the COVID-19 pandemic, overall economic conditions globally, vehicle production trends and consumer demand for vehicles, the company is withholding revenue guidance for 2021 until better data becomes available. Despite the fact that the company is withholding guidance for 2021, the company remains confident in its ability to continue to outperform its primary underlying markets.

With the onset of the COVID-19 pandemic, many government-driven shutdowns and the obvious change in demand we estimated that we would be facing in the second quarter, the company began to look at cost optimization concepts very early in the second quarter. This led to the lower estimates for operating expenses, capital expenditures and depreciation and amortization levels that we provided in our first quarter conference call. However, as the quarter progressed, we quickly realized that those changes would not be sufficient given the drastic shift in demand we were experiencing.

Our updated estimates for the second half of 2020 set forth today represent the planning, idea generation and fast but thorough execution of many cost-containment initiatives we have made to adjust the company to our new levels of revenue. Despite the fact that the second half of 2020 revenue will be lower than we were expecting at the beginning of this year, we are optimistic that the forecasted improvements in light vehicle production throughout the second half of the year in addition to our significant cost reduction initiatives achieved during the quarter will allow the company to return to more normalized gross margins and operating margins.

Our cost-containment efforts were all undertaken with a very clear objective that we needed to protect the most critical resources necessary to continue our launch of sold programs and to support the team that leads our research and development as they are imperative to the future growth of the company. We believe that this strategy of creating cost savings while protecting our future growth opportunities will provide above market returns for our shareholders over the next several years.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from James Picariello with KeyBanc Capital Markets.

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Just on the -- to start on the structural cost-outs here. What's the timing of the remaining actions left? And when do you expect to achieve that full $35 million run rate in savings?

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

Yes. All those actions and those numbers are completed. So literally, those will start right now through -- they'll begin at the beginning of the third quarter. So same start of end of Q3 and should be -- basically, half of that should be experienced in the second half of the year. So the $35 million (inaudible) annualized number, but we'd expect to see about half of that flow through during 2020 and Q4.

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

And would that show up all-in in SG&A? Or will some also hit [RD&A]?

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

No, it's about 60% of it is actually in the overhead or the cost of goods sold area. The rest of it is in the R&D and SG&A. You still there?

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Yes. I'm here.

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

Okay. Sorry. Did you hear --

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

I missed all of that. Sorry.

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

Yes. So about -- of the savings of the $35 million, about 60% of it is in the cost of goods sold area and the fixed overhead reductions. And then the rest of it is split between our research and development and the SG&A areas. So OpEx.

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Got it. And then the gross margins for the second half, I would say, clearly, there's some positive mix baked in. Is that mainly driven by FDM and HomeLink? Is there any benefit tied to maybe some visibility within exterior mirrors, which is an obvious margin benefit to you guys in terms of the mix?

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

Yes. I think when you look at the -- we're obviously continuing to expect FDM to continue to grow, which is going to help offset some of the headwinds we're seeing in lower vehicle production. Some of the -- with the lower vehicle production, what do you expect to see is some drop-off in overall IEC growth rates obviously, if that's base mirror, then you'd expect there would be a little bit of a margin tailwind associated with the stronger mix.

But one of the things that we're also looking at is we're expecting that the other portions of our business, so in aerospace, especially, is going to definitely take a hit. And so what we're seeing is that the strength in automotive and ITM, FDM and really in consistency in OEC is going to help offset some of those other headwinds.

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Got it. And maybe just 1 housekeeping one. On the Driver Assist and SmartBeam headwind, you guys kind of talked -- maybe it was 2 quarters ago now. You talked about what the headwind looks like for this year and even into next year. How has that changed now with the pandemic?

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

I'd say it's about in line, and that business basically changed -- the pandemic impact basically impacted that the same as it did rest of the business. So in terms of the headwind, it's pretty similar to what we are expecting for the full year, it's right in line.

Obviously, going forward, the question is, are those -- as we're winding down those Ford programs for Driver Assist, are they going to be able to launch on time to finish off those programs with their next supplier? And that will probably take later this year to early next year to see -- to make sure that stays on the course, but we don't expect any delays at this point.

James Albert Picariello - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Is there any chance for a reunion with Mobileye now that Ford and Mobileye are working together going forward?

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

No. I mean, we quoted that -- I mean, they -- Ford asked us to quote that project. We declined to engage. When we looked at the margin profile of that business in comparison to the business case of what it was going to cost to launch and from an R&D standpoint, we just couldn't make the numbers work. It did not meet our business needs. And so we voluntarily walked away from that business. And I think our strategy is to continue to say no to those type of projects.

Operator

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

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

This is Aileen Smith on for John. Thank you very much for the guidance on the second half. It's really helpful. As we think about wave 2 COVID outbreaks across the country and possible incremental production shutdowns, is this being contemplated in your outlook at all? Or any level of conservatism that you're applying for possible disruptions of the supply base?

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

On the supply base side, yes, I mean, we -- one of the things we've been watching. The good news over the last couple of years, there's been a lot of supply concerns. Whether that's part shortages or geopolitical issues, you name it. So I mean, we've become pretty well versed in making sure we've derisked the supply base as best we can anyway.

When you talk about it from a production standpoint, though, like would this affect our one of our customers and would there be a plant shutdown or vehicle production slowdown? That's one that's really hard to predict. Obviously, we tend to take a pretty conservative approach when we look at IHS estimates. So we're not overly aggressive here. We always assume that there's a little bit of a bias towards the downside when you're going through an issue. And we try to reflect that in the numbers that we posted for guidance in the second half.

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

Great. Great. That's very helpful. And as you think about the second half and production levels that are still likely going to be lower on a year-over-year basis, do you have any expectations for decremental margins? And how they will stack up versus the second quarter, particularly in light of your cost-containment actions that you discussed? And then as we get on the other side of the crisis, is there any idea about how we should be thinking about incremental margins?

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

Yes. Well, if you look at decrementals first, I mean, really, what that -- if you take the midpoint of that guidance, you're seeing a 50 to 60 basis point kind of on a year-over-year basis in the second half, is what that would indicate. So we would see the slight sales decline driving a slight decremental margin. But honestly, at 50 to 60 basis points, it's really more about product mix. And overall sales levels. Our ability to cover overhead costs at those sales levels. So we feel really good about where we're at right now.

We're not expecting -- unless something really drastic happened to the revenue, the Q2 margin is really an anomaly because there just -- there was not enough sales to even come close to covering the fixed overhead portion of the business. So we don't think that's anywhere in the vocabulary of what we're expecting for second half. Literally, that 36% to 37% margin that we guided to for the second half, we feel pretty confident about as long as sales are within 5% or 10% of what we guided.

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

Okay. Great. And last question. You cited customer price reductions as an additional margin headwind in the quarter. I think you've commented in the past that those customer price reductions are typically seasonally toughest in the first quarter. Was there any spillover effect into the second quarter? Or perhaps OEMs getting tougher on cost as the macro environment collapsed? Or were they pretty consistent with what you've seen seasonally?

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

Great question. They're pretty consistent. It's pretty much weighted towards the first half of the year. But when you compare it to -- when we're looking at Q-over-Q, so second quarter last year, second quarter this year, we know that on average, our pricing is down 2% to 2.5%. And we haven't seen anything that's higher weighted at this point versus other years. So it's been pretty consistent.

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

And 1 thing I will point out, the reason why you'd see a bigger impact in Q2 as many of our Asian customers are on a traditional fiscal year, which would be April 1 price downs for those. So if you look at the business during Q2, North America basically shut down completely. Europe was pretty much nonexistent. A lot of our business was in Japan and Korea and in places where you have a little later than January 1 price downs that take effect. So those customers that we're shipping were -- most of them were weighted towards an April 1 price down date.

Operator

Our next question comes from David Kelley with Jefferies.

David Lee Kelley - *Jefferies LLC, Research Division - Equity Analyst*

I guess, jumping back to last quarter, you talked about shipment timing and the impact inventory work down can have early in a downturn. I was curious if you could provide some color on the Q2 impact you saw from that inventory work down and maybe how you're seeing channel inventories stacking up today.

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

Yes. Well, at the end of Q1, it was interesting. The actual shutdowns had started right at the very end of Q1. We were continuing to ship. So we definitely think that a little bit of sales that normally would have happened in Q2 happened at the very end of Q1. And so then there is what we're expecting and hoping for, and we'll see as we progress through the quarter, is that you would expect to see some shipments at the early part of Q3 start to ramp up to help catch up with what did not happen obviously throughout Q2.

So what we do know for sure is that OEM inventory levels are pretty low. Especially in GM's case, and if you look at between the UAW strike at the end of the quarter -- first quarter and the impact that had on their overall inventory levels and then the shutdowns, we feel like there's going to be a step-up in the GM business for a while based on them needing to get inventory back on the dealer lot. So we're hopeful that, that helps drive sales in Q3. The bigger question for us and the one that I think is $1 million question, obviously, is what -- how long does that last? And what is the long-term economic impact to a consumer? And how do consumers handle Q4? And what is the overall sales and SAAR levels going to be in the second half of the quarter -- of Q3, but then also into Q4 and next year. That was going to be a tougher one.

We think Q3 is going to be solid primarily just because of inventory levels being where they're at and needing to play catch up. But then the question is the longer-term economic impact of the shutdowns and of the pandemic.

David Lee Kelley - *Jefferies LLC, Research Division - Equity Analyst*

Okay. That's great. And maybe on that playing catch up point, do you see any risk to -- whether it's from the supply chain standpoint or sourcing risk if we have to and seem to be ramping up pretty aggressively here in North America?

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

Yes, there's definitely -- you definitely see some suppliers that are trying -- try to get employees back into buildings, trying to follow social-distancing guidelines. Each state kind of has their own requirements of what that looks like. So trying to get the same number of people back into the same footprint is difficult for certain of our supply base and for ourselves at times as well.

So what we've been doing, though, is throughout this entire shutdown period, trying to stay in communication with the supply base to make sure when this does fire back up again, what is their confidence level? How many -- what percentage of their employees are coming in and reporting and working? What percent of capacity are they at? And so we feel like we've done the best we can to make sure we've mitigated those risks. And any place that we do have concerns, we're aware of that and watching those suppliers carefully.

David Lee Kelley - *Jefferies LLC, Research Division - Equity Analyst*

Okay. Perfect. And then last one for me, and I'll pass it along. Just curious if you could talk about gross margin cadence throughout the quarter. We're hoping to get a sense of run rate in June. And then as we think about the second half, any thoughts on sequential ramp? Will gross margin be more Q4 weighted? Just curious about cadence go forward as well.

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

Well, I think first, I'll jump in on Q2 and say that April and May, and when you look at sales in Q2, April and May were basically nonexistent other than some of our Asian customers. In June, we started to see a pickup in sales and margins. Margins in the month of June were far better than they were in April and May, much more -- not quite to the level that we just gave guidance, but much closer to. And that's what gives us the confidence when we give that guidance in the second half of the year, that 36% to 37%.

We expect sales to be slightly better than they were in the month of June, and it should have a positive impact on gross margins. So I wouldn't expect Q3 to be drastically different than Q4. We think both quarters really should be in that range that we gave for the gross margin guidance.

Operator

Our next question comes from Josh Nichols with B. Riley.

Michael Joshua Nichols - *B. Riley FBR, Inc., Research Division - Senior Analyst of Discovery Group*

Yes. I did want to ask, could you comment a little bit about what you're seeing as far as the penetration rates for the companies like dimmable glass and interior and exterior mirrors, particularly in North America?

Any commentary as far as the mix of vehicles that are being sold today, if you're seeing more or less that may have these like higher-end features that typically have these add-ons like dimmable glass?

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

Yes. I'd say the penetration rates have actually held up, I mean, really well. The bigger challenge -- so we haven't seen a content change for any of our products, and we haven't heard anything from our customers that would imply that they're going to change kind of how we're packaged or that our penetration rates will change through this. Whether it's good or bad, we're not entirely sure. But if you actually look at the segmentation during Q2, and the forecast throughout the rest of this year, it was pretty evenly spread across all segments.

In other words, it's not like D and E cars continue to sell and A, B and Cs didn't. Literally, the production happened across the board, across all segments. So if you look at those down rights, there's a little bit of variability. But for the most part, it was pretty much evenly spread across all the regions at those rates and across all segments in those regions. So as of right now, we don't expect anything to change in terms of our mix, our overall penetration rates in our primary markets.

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

And one thing to add is if you -- Neil's commentary about the 8 new launches with FDM, very heavy in the GM lineup, and those are very strong vehicles. And as they launch and build back that inventory, like Steve mentioned, you would expect that there may be a little bit overweight volume on the advanced features in the quarter.

Michael Joshua Nichols - *B. Riley FBR, Inc., Research Division - Senior Analyst of Discovery Group*

Great. And then on that question, like how are you looking in terms of inventory level at the company's large customers right now? And do you feel comfortable with where you guys stand right now for this reramp that we're seeing take place a lot of auto manufacturers in the U.S. and also in Europe?

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

Josh, you mean our inventory at the OEM? Or the OEM's inventory at dealers?

Michael Joshua Nichols - *B. Riley FBR, Inc., Research Division - Senior Analyst of Discovery Group*

I guess, how one are your -- how are the OEMs inventory right now for your products?

And two, are you comfortable with where you stand to be able to fit the needs of the reramp as that accelerates in the coming months?

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

Yes. So well, on our ability to meet demand from our customers, we feel very good about that. I mean, the nice part about -- the hard part about Q2 is that given our commitment to automation and what we have in terms of capital equipment, it's really hard to scale that in a quick downturn. That's really why you saw the massive decremental margin in Q2.

However, it also does give us the upside of being able to respond to demand if that ramps quickly. So obviously, we would need people to help us build those parts, but at the same time, the structure, the infrastructure, the capital equipment's here and ready to go. So we don't feel concerned about a ramp-up and not being able to meet demand for our customers.

In terms of where our customers themselves are, I think the good news of this, if there is any, is that vehicle inventory levels are pretty low on a historical level, especially with certain OEMs and so that really should set us up well at least in Q3 as they look to rebuild those inventory levels at the dealerships. That should really help bolster our sales in the quarter.

Operator

Our next question comes from Ryan Brinkman with JPMorgan.

Unidentified Analyst

This is [Ben] (inaudible) on for Ryan Brinkman. I just have 2 questions. One is of the first 6% reduction in OpEx in the second quarter from wages and discretionary spending, how much of that would you expect to permanently eliminate from the cost structure?

And thinking about when the spending starts again, how should we think about spreading those numbers over the next few quarters? And I have one more question.

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

Yes. So on the wage reductions, really, that $35 million savings on an annual basis, about 40% of it is coming through the operating expense category. So if you were to take the half of that for the back half of the year, you'd be able to get to that number. And then the discretionary spending, I mean, things like travel are still impaired severely, meaning there's shutdowns where our travel is limited severely. So we would expected that, that to come back slowly over time. But as long as there's still the pandemic, travel is going to be impacted.

And then things like other discretionary items are -- we're keeping a close lid on as we continue to ramp sales and things like that. But we're -- we continue to fund program-related costs and things needed to continue our launch and development of programs. So we're taking a much closer look at that, but I would expect it's still going to be depressed expense-wise over the next 12 to 18 months.

Unidentified Analyst

And a follow-up to that. When is spending coming back, when the CapEx started to come back, how should we think about Q3, Q4 and then the first 2 quarters of next year?

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

Yes. I think we had given guidance for that $60 million to $70 million on an annual basis. We spent about $30 million through the first 6 months. We have a couple projects that were in process, and those are continuing throughout the year. It's going to be pretty even flow throughout the back half of the year.

Next year, I would expect it to be -- it really depends on how light vehicle production ramps. But we do have, from an equipment perspective, capacity that's obviously underutilized right now. So we feel pretty good that we'll probably be in a little bit lower capital expenditure budget going into 2021 as well, just given the fact that the light vehicle production market has dropped considerably.

Things that would change that, though, is if we have considerable growth in FDM that we don't have capacity for and some of the other advanced projects.

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

Want to be clear, we would expect if the business continues to grow into 2021, it will be higher than the CapEx spend was in 2020. So $60 million to $70 million for this year, $30 million to $40 million in the second half is what our CapEx guidance is for Q3 and Q4. We would expect if the business responds the way we hope it will in 2021, that -- it will definitely be higher than that $60 million to $70 million range for this year. But the -- but not all the way back to that $100 million range we were running or guided to last year.

Unidentified Analyst

Got it. Got it. That's really helpful. And just my last question related to the large dimmable sunroof. What is the progress on the large dimmable sunroof? I know that you showcased the product back in CES earlier this year, and so far, we only seen this product on a (inaudible)

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

Yes. So we're continuing -- Neil's team is continuing to focus on the development aspects of what that product looks like. A lot of testing. There's a tremendous amount of work that has taken place and will need to continue to take place. Especially that allow us to give samples and prototypes, proof of concepts to our customers. So really looking at kind of a 24 to 36 month window before we probably will have -- hopefully, get to the point where we have a program announcement or at least feel confident enough to take that next step with an OEM customer.

Operator

Our next question comes from Mark Delaney with Goldman Sachs.

Mark Trevor Delaney - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Yes. My first question is on the new 2020 guidance for revenue that's implied based on the 2H guidance and 2Q results. And I think if I put that together, the new 2020 revenue outlook is a bit below what the company had been expecting as of last quarter.

And the IHS production numbers that the company is using, I think, are still pretty similar, down about 20%. So I'm hoping to understand what's the bridge to the new implied 2020 revenue outlook compared to the prior view?

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

Yes. Well, it is slightly lower than what our previous guidance was. But you have to remember on April 24 when we posted Q1, the pandemic was just starting. We were all expecting that the state shutdowns would be over by mid-April. That obviously continued into May. And those rolling shutdowns happen not only in North America but then in Europe. And so yes, and if you look at production estimates then versus what they changed to now, it's drastically lower than what it was then. And that's what the primary driver of the change in revenue guidance.

Actually, our revenue in the second half has held up very well in comparison to what our initial forecast was for the second half of the year. The majority of the impact that you're seeing was all actuals in Q2. And it was really driven by the extended state shutdowns and production shutdowns at our customers.

Mark Trevor Delaney - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Okay. That's helpful. And my follow-up was to better understand qualitatively what the operating environment is in terms of engaging in new projects with your customers? And is the company being able to still complete projects and win bookings in a more virtual environment? Or is there anything that's taking place there that's so problematic?

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

No, that's actually a great question. It's probably one of the harder things to do is how do you how do you bring up, especially given what we sell and the type of products that we tend to introduce to our customers, it's really difficult to introduce new technology when in a virtual environment.

Obviously, the other factor is, as many of our customers are dealing with cost and pricing pressure issues and trying to work-from-home issues. So it has definitely put a slowdown in terms of how you can ramp new product concepts with your customer. Certainly, you're not dropping off proof of concepts and letting them drive vehicles the same way.

So that's probably been the most difficult part of this is looking out 3 to 5 years, how do you make sure that you keep an eye on growth rates and new technology that will help propel the company in that 3 to 5-year window. And so that one is one we're still working through. And so there's a lot of creative ideas. Fortunately, in some of our markets, like Neil mentioned, the Toyota Harrier DVR launch in Japan. It was -- Japan continued to work through a lot of the pandemic. And so we were able to -- our team in Japan was able to do a great job continuing to push our technology with that customer. And fortunately, that's got a lot of excitement at Toyota for new products, the new product concepts of what we can do, not only with mirrors, but literally with our camera systems and digital driver quarters. So we're excited about that.

There's no doubt, though, that with certain customers, it's more difficult now to introduce new products. The fortunate part is, if there is anything good news in there, it's the same for everybody. All suppliers are struggling with how do you engage with the customer working remotely or through some of the job eliminations that have been announced with certain of the OEMs.

Operator

Our next question comes from David Whiston with Morningstar.

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

First, on the $35 million in cuts. I was just curious what -- how much of that is just straight by-product of headcount reduction? And what percent of your headcount has fallen due to these cuts?

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

100%.

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

It's all people? Okay.

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

Yes.

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

Okay. And on the supply chain, I guess, 2 questions there. Is there any going upstream for you? Is there any weakness in getting any shortages in terms of getting raw materials, electronics? And then any -- do any Tier 2 or Tier 3 players have working capital issue with the ramp-up coming now?

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

Right now, we're not seeing any issue in terms of supply chain, making sure we get enough volume. The one nice thing -- I mean, if you think about where we were 18 months ago, automotive was -- had grown quite a bit. There was a lot of constrained suppliers in terms of that capacity.

Given the slowdown in the lower volumes, we feel pretty good about not having that issue for the foreseeable future in terms of bumping up against capacity issues in the supply base. Sorry, David, you had one -- there was a second part of that, that...

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

I was just asking both about the availability of things. And then also, do any of the upstream players have a working capital issue ramping (inaudible) ramping up.

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

Well, that one is probably the most concerning, quite honestly, is as you look at the supply base, automotive is pretty notorious for having pretty thin margin profile. So as you take 20%, 30%, 40% of the volume out of the game, what does their decremental margins look like? What is their ability to maintain profitability and stay liquid through this?

So that's one that our team, our purchasing team continues to look at. It's one of the key factors that they have been better at over the last several years is understanding the overall financial health of the supply base. So that's one we'll continue to look at. We do have -- we do know the suppliers that have issues with those, and it's something we continue to watch and monitor to make sure that they're okay financially, not just their ability to produce parts, but ability to stay solvent.

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

And then going downstream from you guys at the automaker level, are there any disruption that these -- your customers' plans from either part shortages unrelated to Gentex or worker absenteeism that's preventing Gentex from making shipments to your customers?

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

Nothing I would say that's preventing us from making shipments. Early in the process, there were definitely some issues around other suppliers. Based on where they were, government-based shutdowns, you name it, not able to get parts in that caused some automakers some problems. So that definitely probably did impact the quarter, especially in Q2. We're not anticipating that being a huge problem going forward. The supply base, for the most part is pretty much up and operational, and most of our suppliers are running at pretty high levels in terms of their efficiency versus where they were prepandemic. So we don't feel like there's a huge risk factor to that right now. If the strength continues to happen through Q3 and Q4, obviously, that could be a problem as it relates to availability of labor, but then also availability of components at our customers.

Operator

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 - *Gentex Corporation - Director of IR*

Thank you, everyone, for your time and attention today. We appreciate the questions and the call, and we hope everyone has a great weekend.

Operator

Ladies and gentlemen, thank you for participating in today's conference. You may now disconnect.
