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GNTX - Q1 2020 Gentex Corp Earnings Call

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OVERVIEW:

Co. reported 1Q20 net sales of $453.8m, net income of $89.5m and diluted EPS of $0.36. Expects 2020 net sales to be approx. $1.58-1.67b.

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CORPORATE PARTICIPANTS

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

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

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

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

Gavin Lorne Kennedy *Jefferies LLC, Research Division - Equity Associate*

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

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

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

Ryan J. Brinkman *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Gentex Reports First Quarter 2020 Financial Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Mr. Josh O'Berski. Thank you. Please go ahead, sir.

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

Thank you. Good morning, and welcome to the Gentex Corporation First Quarter 2020 Earnings Release Conference Call. I'm Josh O'Berski, Gentex' Director of Investor Relations, and I'm joined 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 first 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.

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

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

Thank you, Josh. For the first quarter of 2020, the company reported net sales of $453.8 million, which was a decrease of 3% compared to net sales of $468.6 million in the first quarter of 2019. The impact of the COVID-19 pandemic and the resulting shutdown of the automotive industry in various parts of Asia, Europe and North America resulted in an estimated negative impact on net sales of approximately $40 million for the first quarter of 2020. The company's decrease of 3% in sales was in comparison to global light vehicle production levels that dropped 24% for the first quarter of 2020 when compared to the first quarter of 2019.

For the first 2 months of the quarter, top line revenue growth was progressing in line with our forecast with modest negative impacts coming from reductions in China as a result of the pandemic. But by mid-March, the pandemic was negatively affecting European OEMs more significantly. And then the North American production environment was brought to a grinding halt. The vast majority of the $40 million shortfall in sales occurred during the last 2 weeks of March. For the first quarter of 2020, the gross margin was 34.5% compared to a gross margin of 36.2% for the first quarter of 2019. On a quarter-over-quarter basis, the gross margin was impacted primarily by lost sales due to the pandemic and annual customer price reductions. When compared to the first quarter of 2019, product mix improved, which partially offset some of the sales losses and price reductions. The improvement in product mix was primarily driven by Full Display Mirror and exterior mirror growth.

The gross margin for the quarter held up well when considering the significance of the lost sales and how quickly and unexpectedly, the demand from our customers changed. During the first 2 months of the quarter, our gross margin was on pace to be in the range of our original annual guidance. Operating expenses during the first quarter of 2020 were up 7% to $51.6 million when compared to operating expenses of $48 million in the first quarter of 2019. The increase in operating expenses continues to be driven by headcount and other resources focused on new product launches as well as research and development of new products. CES 2020 created significant interest in our existing and new technologies, and we continue to believe in the long-term value that our new product offerings and technologies will create for our customers and the resultant trajectory that this can create for our business.

In terms of execution to our budget, operating expenses were in line with our original guidance, which were planned to increase at approximately the same rate as sales for the year.

Income from operations for the first quarter of 2020 decreased 14% to $105 million when compared to income from operations of $121.6 million for the first quarter of 2019. The reductions in operating income were largely due to the lost sales stemming from the pandemic and the overall lower gross margins in the quarter.

Net income for the first quarter of 2020 decreased by 14% to $89.5 million compared with net income of $104.3 million in the first quarter of 2019. The reduction in net income was from the lost sales due to the pandemic and the impact this had on gross margins. Earnings per diluted share for the first quarter of 2020 decreased 10% to $0.36 when compared to $0.40 for the first quarter of 2019 primarily as a result of the impacts of the pandemic on net income, which were partially offset by the impact of share repurchases.

In the first quarter of 2020, the company announced a 4% increase in its dividend rate, marking 10 straight years of year-over-year dividend increases. Also during the first quarter of 2020, the company repurchased approximately 7 million shares of its common stock at an average price of $25.48 per share. As of March 31, 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 first quarter financial details.

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

Thank you, Steve. Automotive net sales in the first quarter of 2020 were $439.9 million compared with automotive net sales of $455.8 million in the first quarter of 2019. The 3% quarter-over-quarter decrease in automotive sales was driven primarily by a 6% quarter-over-quarter decrease in interior auto-dimming mirror unit shipments due to the 24% reduction in global light vehicle production.

Other net sales in the first quarter, which includes dimmable aircraft windows and fire protection products, were $13.9 million, an increase of 9% compared to other net sales of $12.8 million in the first quarter of 2019.

Balance sheet. In terms of the balance sheet, the company ended the quarter in a very strong liquidity position. And to bolster that, the company drew down $75 million on its $150 million line of credit. The company has an additional $75 million available to draw on as needed. The drawdown was a precautionary step given the volatile market and unknown length and severity of the pandemic.

I'll highlight a few key balance sheet items as of March 31 as compared to December 31, '19. Cash and cash equivalents were $278.5 million, down slightly from $296.3 million primarily due to the cash flow from operations and the proceeds from the $75 million draw on the line of credit, which was more than offset by share repurchases, dividends and capital expenditures. Short-term investments were $131 million, down from $140.4 million. Of the $131 million, approximately $70 million are in CD and investments that are scheduled to mature in the second quarter of 2020. Long-term investments were $177.8 million, up from $139.9 million.

Long-term investments include FDIC-insured CDs, treasury notes as well as corporate and municipal debt. The portfolio is currently well positioned with over 90% of the corporate and municipal holdings invested in A-rated or better institutions. Accounts receivable declined slightly to $233.6 million from $235.4 million with all Tier 1 and OEM customers and good standing as of the end of the quarter.

Inventories were $251 million, up slightly from $248.9 million primarily as a result of increased raw materials. Our purchasing and supply chain teams continue to manage through supply chain stresses, which have included managing rolling shutdowns in our supply base, managing runout situations on certain components and then adjusting order volumes heading into the second quarter and balance of 2020 based on the current forecast. Accounts payable increased to $100 million, up slightly from $97.6 million. And accrued liabilities were $163.9 million, up from $74.3 million. The increase was primarily due to the $75 million draw on the company's line of credit.

Looking at the cash flow statement. The first quarter 2020 cash flow from operations was $151.3 million, up from $133.8 million in the first quarter of 2019. Cash flow from operations was impacted by lower net income in the quarter, but was more than offset by fluctuations in working capital. Capital expenditures for the quarter were $15.6 million compared with $16.8 million for the first quarter of '19. And depreciation and amortization for the quarter was $26.3 million compared with $28.1 million in the first quarter of '19.

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

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

Thanks, Kevin. In the first quarter of 2020, there were 12 new nameplate launches of our interior auto-dimming mirrors and electronic features net of previously disclosed feature headwinds. Despite the troubling economic conditions, the net launch rate for inside auto-dimming mirrors and advanced features was the highest first quarter launch rate of the last 3 years. During the quarter, there was a good mix of both auto-dimming inside mirrors and advanced features. The base inside auto-dimming mirror launches included new models in all of our major markets despite the pandemic, while advanced feature launches were led by new models for both HomeLink and Full Display Mirror.

Now for an update on our Full display Mirror product. We're excited to announce that we are now shipping FDM on the Cadillac CT5 and Land Rover Defender, Lexus LM, Chevy Corvette and the Mitsubishi eK Wagon and eKX vehicles.

The newly launched FDM for Mitsubishi is our seventh OEM launch and represents another win with a Japanese OEM, which we believe speaks to the global appeal of this product for our customers. Here's a comprehensive list of the OEMs and the number of nameplates we are currently shipping FDM. General Motors, our initial launch customer, has 19 different nameplates shipping. Subaru is currently shipping on 3 nameplates. At Nissan, we are shipping on 2 nameplates. For Toyota, we are now shipping on 8 nameplates. At Jaguar Land Rover, we are currently shipping on 4 nameplates. Aston Martin was announced earlier this year as our sixth OEM, but shipping will begin around midyear, and today's announcement of our seventh OEM, Mitsubishi, is shipping on 2 nameplates.

As we look forward to the second quarter and the balance of the calendar year, we realize that many of our customers' expected launches of new vehicles may be affected by the pandemic. However, we are optimistic because we continue to see strong demand for our latest products, like FDM and ITM, and the new products that we debuted at CES.

In summary, we're pleased to be able to show progress in the launches of additional Full Display Mirror systems with our existing OEM customers and are very excited to introduce Mitsubishi as our latest FDM customer despite the difficult vehicle production environment that we are facing.

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

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

Thanks, Neil. The company's current forecast for light vehicle production for 2020 is based on the mid-April 2020 IHS market forecast for light-vehicle production in North America, Europe, Japan, Korea and China. The company's forecast also takes into account the fact that many of our customers are on full or partial shutdown with some of our customers not scheduled to resume operations until mid-May or later. Based on this information, light vehicle production forecast in our primary regions for the second quarter are expected to decline 42% from last year and for calendar year 2020 are forecasted to decline 20% compared to 2019. Based on this light vehicle production forecast, the company's current estimate is that net sales for 2020 will be approximately $1.58 billion to $1.67 billion for the year, which represents a 10% to 15% reduction when compared with 2019.

Based on these lower sales, we are currently forecasting a gross margin in the 34% to 35% range for the calendar year. Gross margins for the second quarter are expected to be the lowest of the year, due to the significant impact of sales that have occurred so far in the month of April, but will be largely dependent on the rate at which our customers begin to emerge from their shutdowns and at what volume they produce. As volumes hopefully build through the second quarter into the third and fourth quarter, we are optimistic that margins will reach their high point in the back half of the year. In an effort to size the company appropriately, given the new lower sales levels, the company is also lowering guidance for operating expenses by $10 million to between $195 million and $205 million for the year. This lower level of operating expenses will be achieved through a combination of headcount reductions and other cost-control initiatives that are already underway at the company.

The bottom end of the tax rate guidance has been increased by 1 percentage point to reflect the anticipated lower discrete benefits from stock option exercises of our employees and the reduced FDII benefits due to the geographical mix changes within our customer base due to the impact of COVID-19. In an effort to preserve capital and lower future expenses, the company has undergone a significant effort to lower capital expenditures for the year. We have reduced our capital expenditure guidance for the year by $25 million, which means our new projection for CapEx for 2020 is between $60 million and $70 million. Based on the changes to our CapEx budget, we now estimate that our depreciation and amortization for 2020 will be approximately $3 million less than previously forecasted and will end the year between $102 million and $107 million.

Based on the difficulty and uncertainty of global light vehicle production data for 2021, the company is withdrawing its revenue guidance for 2021 until better data becomes available. Despite the fact that we are withdrawing guidance for 2021, the company remains confident in its ability to continue to outperform the underlying market.

Over the last several weeks, COVID-19 has created unprecedented circumstances for our industries, which included massive changes to production levels at our customers. Our industry has also been significantly influenced by federal, state and local governments in each of the countries where our customers operate. Unfortunately, many of these changes have come with little or no advanced warning, which makes it very difficult to forecast sales or build a sustainable operating model.

Our focus over the last few weeks was directed at protecting our employees, while still supporting our global customer base from our centralized manufacturing footprint. Over the coming months, we will continue to work to ensure that our cost structure accurately reflects industry production changes and new business realities. Our overall commitment to new product research and development will remain one of our top priorities for investment even as we look to optimize our cost structure. We remain optimistic that we can continue to provide above-market returns for our shareholders, by leveraging our current product strategy and through the execution of our lean organizational structure, which provides the speed and agility necessary to respond quickly to and manage through this new business environment.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Chris Van Horn with B. Riley FBR.

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

So there's been various reports about how the production restarts are going to happen and the timing and dependent on -- and there seem to be dependent on region as well. Can you just give us an update on your conversations with your customers by region? And what you're kind of seeing real time?

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

Yes. So if you start -- we'll kind of follow the flow of the pandemic itself and success of a logical restart. It's kind of when it started and then moved out of different regions. But for us, what we're seeing, for instance, in China and Korea, Korea really didn't shut down that much. There were some modest changes to the production levels as the pandemic was moving through the country. China, obviously, went to a hard stop, then has restarted for the most part. So we're seeing increase in orders in the Asian market, especially China and Korea. Obviously, Japan is going through it right now. So we are expecting some impacts over the next few months in the Japanese market. But right now, they are currently building it at most of the factories that we supply. Europe, like the U.S., has gone through a pretty significant hard stop as well. The expectation from a lot of our customers in Europe and in North America are that restarts happening early may through mid-May. Those are going to be pretty slow ramp-ups, starting maybe with single shifts or lower volumes than hopefully getting back to higher production levels. We are expecting or what our customers are talking about by the end of May, beginning in June. Obviously, there's some UAW conversations that came out this morning that may change with what the Detroit 3 are planning from a restart of production, but we're still waiting for anticipating additional information from them in this week.

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

Okay. Got it. And then kind of on that same vein, how is your supply chain holding up? And have you seen disruption on things that you're taking in-house?

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

Yes. I mean there is -- obviously, anything coming from China a few weeks ago was stopped. So that was a problem. Luckily, given our balance sheet, we tend to carry a slightly higher inventory levels, and that has helped us weather most of the supply issues. We do see rolling changes happening, like Kevin mentioned in his comments, a lot of it's coming from suppliers in Southeast Asia, where countries are starting to go into shutdown modes in various parts of the world. Mexico, there's definitely some supply constraints that are happening. Fortunately for us, we don't see anything that really impacts us at least through the end of May. So we're watching it closely and trying to work with our supply base to make sure that we have continual flow of product. We don't see anything that should impact sales in the short term.

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

Okay. Got it. And then last for me. How are the new business conversations going? I mean, I imagine you can still have those remotely and I imagine there's still some expectations that there'll be some return to demand, and certainly, your technologies are going to want to be part of that snapback. So how are those conversations going?

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

Yes. I would say the conversations themselves are going really well in terms of -- the customers are still going through the quote processes and looking at the business development plans that we've had in place. The biggest issue or the thing that we're most concerned about isn't the level of conversation, it's more about the realization that over the next several months, OEMs are going to have some budget concerns and those budget good concerns are going to drive changes to the launch rate of products. So some OEMs have already made statements about pushing out new launches or delaying those slightly. Certainly, there's -- budget is going to become a bigger concern for every OEM. So one of the things we're watching there is what our engineering resource is going to look like at our customers. Are they going to be able to launch all the vehicles and all the new product concepts that they've worked on together. So as of right now, all those conversations are still ongoing and moving quite well. But we're also not naive to think that over the next several months, there's going to be -- there's going to have to be a pullback in the availability of resources with some of our customers.

Operator

Our next question comes from Ryan Brinkman with JPMorgan.

Ryan J. Brinkman - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Just a follow-up, I guess, on supporting your global customers from Michigan as they restart production. Firstly, can you talk about what manufacturing, if any, is taking place in Zeeland today? And then secondly, are you able to quantify, you mentioned, the inventory that's out there in the field overseas? Given it seems the U.S. is sort of the last major market to be hit by the virus. The last pick at the come down might be the last to come back up. China, I think, is already back online. Europe probably set to be next. How confident are you in your ability to support that sort of different restart to production in different regions at different times?

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

Sure. Yes. So the state of Michigan has been on a lockdown really since late March. And so one of the things that we've been focused on is making sure we're following our state's orders and mandates. What we're doing is we're just building essential items that are necessary, and we're doing that through a volunteer staff. And so as many people as can be home, we're having them stay home. Really just looking for volunteers to meet those necessary orders. We've taken some of the inventory stuff that's on surface, shipments to our customers out of there. So we're have to go to air freight in certain times to try to meet those demands. So it's not the most efficient shipping situation right now. But we're very confident with the volunteer staff we have. The team has stepped up, and we're very comfortable that we can meet all of our customers' orders with that volunteer team. And obviously, we've done a lot of things differently in our manufacturing floor, including distribution of PPE to our employees to try to make sure we're ensuring their safety without causing our customers, obviously, problems or downtime.

Ryan J. Brinkman - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Okay. That's helpful. And then just finally for me, with regard to the buyback, is a bold move, of course, totally manageable in the context of your liquidity. But I guess I'm just curious about how you are viewing this from here on out. What approach might you take going forward? Should we expect you to maybe pause the aggressive approach post the revolver draw? Or do you intend to continue to be opportunistic?

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

Yes. I think what you'll see us do is we're up -- where we expected to be past the midyear point in terms of repurchases. So our plan in Q2 is to be more conservative with repurchases. However, what we're always watching is what does the cash flow of a business look like. We're managing really well inside of our targeted cash position that we defined about 1.5 years ago. So anything north of $500 million in cash is kind of what our target is. And as long as we're holding up there, then we're going to continue to be opportunistic when we look at the share price and what's going on in the market conditions and what our trajectory of our future business looks like. So even though we were aggressive in the first quarter and we'll likely slow down a little in the second, that's not to say that we're done for the year.

Operator

Our next question comes from James Picariello with KeyBanc Capital Markets.

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

So how should we think about gross profit decrementals as we progress through the second quarter? Because I mean, it does seem pretty clear that you're not looking to dramatically cut SG&A or R&D because of the new product launches and investing for the future, which I completely get. So yes, just curious there. And then how

(technical difficulty)

uniquely challenged environment

(technical difficulty)

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

Okay. So you broke up a little at the end, so we'll hit your first question quickly. If you look at decremental margins, I think it's -- the change from the 36.2% last year to the 34.5% this year. Most of that was driven by the 2 weeks of lost sales that we struggled with at the end of the quarter. If you look at April, you can kind of extrapolate, basically, April has kind of continued what the last 2 weeks of March looked like with very low levels of sales. So if you imagine the entire month of April kind of being at that lower level, like the last 2 weeks of March were, you can kind of get to a rough estimate of what revenue and then you can extrapolate kind of that profitability from there. The real question in the quarter is what does May look like. How quickly are customers going to come back online? At what volumes will they be producing? And then from there, if it returns somewhat to normal, you would expect the second quarter to still be quite a bit lower than what first quarter was, both in sales and profitability. And so when you look at the full year and you look at the impact of Q1 and you see 170 basis point headwind that was really tied to about a $40 million drop. If we hadn't had that $40 million loss in sales, we would have expected it to be right in the heart of our guidance for the year. And so you can kind of extrapolate what that $40 million impact had on overall decrementals. And then what a bigger impact in second quarter will look like on gross profit.

And then James, you kind of broke up on that second part, if you wouldn't mind just hitting that one more time.

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

Yes. Just how would you characterize mix for the year within this -- within the obvious production challenges for the market? Does mix lean positively for Gentex this year?

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

Well, if you look at -- yes, on a year-over-year basis, it's tough to predict what's going to get built in the second half in terms of what dollar content of vehicles will be built. What we've seen so far in Q1 was a very positive mix. If you look at overall OECs have done well in Q1, FDM did really well, even despite the economic challenges. So those are positives for us versus our base auto-dimming mirrors. And so when we look at what we're predicting in the second half, it's really difficult to understand exactly what the impact the pandemic will have on mix. But what we know so far is that mix has been solid so far through Q1. And we're hopeful that, that will continue into the second half of the year.

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

Got it. And then just within the revenue guidance, there's a clear outperformance baked in. FDM is an obvious driver. I thought ITM was more of a ramp-up for next year. So just would be interested in any clarification there. And then exterior domestic shipments once again held in exceptionally well. So just curious if you can maybe help generalize or bucket where the outperformance is deriving from for the year.

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

Yes. I think the key there -- ITM, you're absolutely right. ITM is more of a ramp-up next year than it is this year in terms of volumes. So really, the majority of that growth is coming from our performance and has been coming from performance in outside mirrors, but really, really mainly driven by FDM performance.

Operator

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

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

I got a first question on the ramp back up. Obviously, there's estimates on the timing to start, but nobody really knows exactly how this is going to work. So I'm just curious if you think about sort of early to mid-May is kind of the rough time frame as most automakers looking at. What if that get pushed back to early June to mid-June? How do you sort of flex or get restarted yourself? I mean, what's your ability to say, hey, listen, that May data just is not realistic. We're pushing us back to June. I mean, what are the steps that you have to go through to get up and running? And how flexible are you to deal with what is -- unquestionably is going to be a variable start date we don't know yet?

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

Yes. I think the good news is for us and what probably makes this more achievable given our centralized manufacturing footprint is it's not going to be a hard restart because we're already -- we've already been up and operational to support our international customers. So now it's about achieving scale. So if you assume that you're 30%, 40% operational, maybe 50% at times, depending on the staffing that you have for exports, the ability to scale and move back into 80%, 90% production rate of capacity, we believe we can handle quite well from an internal standpoint because that's just about making sure we have the people, the staffing and all the PPEs necessary to keep our employees safe.

The incoming part side, from an inventory standpoint, is something that our teams are very good at doing. Obviously, you're dependent on your supply base. So making sure that we're giving them ample notice and that we're being clear about our expectations and that we leave time for transportation, which has become a little tougher in this current environment.

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

So you're saying April, you guys are, depending on the day or the week, operating somewhere between 30% to 50% cap? Is that what you're kind of indicating there?

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

Yes, absolutely. A couple -- the first couple of weeks of April were almost nothing because there -- China was still down, about ready to come back up, and so there were very, very minimal operations in early April. But right now, that's about the rate we're running at.

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

Okay. That's very helpful. And then just a second question. As you kind of go through these tough times, often it elucidates some cost opportunities going forward as you get aggressive on cutting costs and some of that cost does not return as you ramp back up to normal. Do you think there's any potential for uncovering some costs that might just not need to return as you ramp back up, hopefully, completely in the third and fourth quarter of this year that might help margins ultimately for the long run?

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

We absolutely believe there's a lot of difficult things that we're going to need to do over the coming months to make sure that we're sizing this business to what the future looks like. One thing for sure is we know it's not going to -- this year and probably the beginning of '21 isn't going to look like our initial budget plans for 2020. And we're estimating close to a $2 billion revenue company. As we're going through that process of getting our size back in line with what the current business is, there will absolutely be costs that don't return -- that we eliminate and that don't return to the business. Some of those include things that people support -- nice to haves, quite honestly, things that things that people get comfortable with or that we've gotten comfortable with that we're going to have to live without for a while. And then what happens out of that is a discipline and a business -- at a business level that won't just walk back into the cost structure of the company. And so longer term, yes, these are very difficult times. But in terms of a 3- to 5-year window, we believe there are opportunities to get better and to get your costs in line for the long run.

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

Okay. That's helpful. And then just lastly, how are the discussions going with your automaker partners as far as pricing? Has there been any kind of step-up in price concessions that they're looking for? Or are there any other actions? I know you said that some programs might be delayed, tough to call at this point. So leave that out for a second. But I mean as far as price concessions or even conversely sort of a more collaborative environment with them that actually might be somewhat better. I mean, is it a little bit more combative where they're looking for more help on price? Or are they kind of play a ball and being pretty collaborative because they obviously need you?

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

No. I think there's always a step-up in intensity of price reduction conversations anytime something like this happens. It's just kind of natural part of the business cycle. Probably the one that you watch the most and what's happening the most with a lot of customers is really talking about payment terms. Obviously, everyone's trying to keep their hands on as much cash as humanly possible. So one of the conversations you have is about price itself and then the other you have is about what are your payment terms and how do you make sure that the liquidity for our customers is there, that they have access to the cash they need. And obviously, payment terms become a large part of that discussion.

Operator

Our next question comes from David Kelley with Jefferies.

Gavin Lorne Kennedy - *Jefferies LLC, Research Division - Equity Associate*

This is Gavin Kennedy on for David. A question on the OpEx guide, it looks like you cut less than sales and you referenced new product launches and R&D. I was just curious if you could provide some more color on the moving parts of the guide, and if there's any other significant drivers we should consider there.

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

Yes. I think on the OpEx side, what you always have to consider is in -- you're only getting partial year credit for that OpEx improvement when you do make changes to headcount and other cost savings initiatives. There are also upfront costs at times in order to achieve those. So the net savings on the OpEx side is what we guided to and what will actually flow through the income statement during the year. But there -- longer term that number would look if you were to annualize that, say, into 2021. So that's why you see a percentage of OpEx change that's slightly less than the impact of sales. But it's also driven by a bottom-up analysis about what technologies, what are our commitments to our customers in terms of hitting launches and what type of engineering staff is going to be required in order to make that happen. So that's really a balance there between the input of what's happening on the top line of the business and what are the requirements from an engineering standpoint to deliver products for our customers.

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

And then one other thing, this is Kevin, that is important to note that some of the things Steve mentioned earlier about inefficiencies in the supply chain, having to go off of the ocean and do airfreight to our customers. That is a cost that is in the SG&A line that will be higher than normal to partially offset some of those savings this year.

Gavin Lorne Kennedy - *Jefferies LLC, Research Division - Equity Associate*

Got it. And then switching gears a little bit. Do you expect to see any changes in the SmartBeam and Driver Assist headwinds given the broader industry pressures? I think you were targeting about 175 basis point headwind in 2020 before the COVID impact.

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

No, I think it's -- those we expect to be about the same. They could be -- I mean, honestly, those are really tied to a certain OEM and so if that OEM -- how they perform and how they do on overall production could change that impact. In other words, it's less about the products themselves and more about how our exposure to Ford and how are they utilize those products in the next 18 months.

Operator

(Operator Instructions) Our next question comes from David Whiston with Morningstar.

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

I guess, first, on the headcount reductions you mentioned, can you say any more detail on that? Are they more in the hourly or salary side? And if salaried, what parts of the company?

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

The ones we're referring to on the OpEx side are all salaried.

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

Okay. Do you anticipate that being one big cut that you've already done? Or do you think you're going to be to do a few more in the next few months? Or is it just a wait and see-type ploy?

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

No, we're taking a very controlled approach and trying to meet with everyone individually to have specific conversations and make sure we're doing this the best way possible, not only for the company but also for the individuals impacted. So this will be something that will take a couple of months for us to work through. It's not typically in our culture. We don't go and make massive changes all at once. We try to do this on a personal level on a one-on-one basis. And so we're working through that real time.

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

And hourly workers, it doesn't sound like you need them all, given your capacity utilization. Are they on furlough? Do they still get full pay? Or how is that working?

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

Yes. So what we're doing for workers who aren't working currently as they are receiving compensation from the company, we've had basically a fixed number of hours that we're paying per week, and that changes as we progress through this time period. But we continue to look at what is the headcount required from an operations standpoint to support the size of the business going forward. And so that's something that we're looking at currently, and we'll be continuing to manage. And it is absolutely our plan to size the workforce to what the overall size of the business is as we -- as our OEMs ramp back up. The difficulty right now is we're trying not to make drastic changes on that side because we don't know for sure what orders are going to look like in mid-May, mid-June when this does ramp back up. So we're trying to scale the business as carefully as we can to make sure it matches and it's appropriate. But there's still a lot of unknowns in terms of when this -- when we emerge from this, is the business going to be at 90% of what it was before? Is it going to be at 80%? Is it going to be at 100%? What percentage of the expectation and the staffing that we put in place? What's going to be the demand for the second half of 2020? And that's something that we're trying to be very careful about and obviously make decisions on, on a daily basis.

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

And sticking with that point you make about what is it going to look like come restart. You have an answer somewhat in China. And China, as you know, was -- had been a slow market pre-COVID anyway. How is it looking to you right now? Is there way more demand than there was pre-virus? Or is it still sluggish? Or...

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

No, I'd say it's actually returned pretty well in China. The difficulty there is, given the language barriers and the difference, it's always in there. You're always -- whenever you go through a shutdown like this, you're always going to see a big spike in a return to normal for a short period of time. The question is, are those volumes sustainable for the remainder of the year? Or is that a huge improvement right away that's going to then taper down back to a more normalized level? And the question is, what is that return to normal? And what is that normalized level? And that's the one that even in China, it's a little too early to tell. Are they going to be 80%, 85% of what they were? Is it going to be 90%, 95%, 100% of what it was?

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

Okay. And Kevin had mentioned you guys already have a raw material buildup. So once your customers already open, do you expect to not have that bad of a working capital outflow because you already have a lot of the inventory in place?

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

Yes. I think a lot of the stuff in March was already committed to from an inventory perspective based on planned builds for back half of the quarter. We did have a little bit of increase there. But our purchasing and supply chain teams are doing the same thing that we are on the business side is evaluating what our order flow looks like through the second quarter and adjusting our purchase materials appropriately so that we don't have a major build in inventory throughout the quarter.

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

But we wouldn't expect it to go much higher than it is currently in order to support the ramp back up of our customer base.

Operator

Our next question comes from Mark Delaney with Goldman Sachs.

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

I was hoping first to better understand how you're thinking about inventory digesting at your customers. I think the company seemingly outperformed auto production in the first quarter, right, about 20 points and your guidance implies about 7 points of outgrowth for the year. So do you think that the inventory gets digested as your customers pretty quickly in the second quarter or more spread out over the course of the year? Any color on that would be helpful.

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

Yes. I think if you look at our expectation, and we think -- 2 things happen, one of them is on the supply side. We know that our outperformance in a downturn like this will be a little higher on the front end. And then on the return, it will be a little less. And the real reason is that production, we're shipping weeks ahead of time before parts end up on cars. So there's that natural lag, which is why our outperformance was so much higher in Q1. We wouldn't expect as it ramps back up that same level of outperformance because we know that there's -- the parts that we shipped in March are going to get used now in May or June. And so we think that will more -- will go back to a more normalized level in terms of outperformance for the year, which has been in that mid-single-digits range for the last couple of years. So we feel really good about that. As you look at kind of what's going on, yes, we think the overall inventory levels are one of the things that we watch in terms of the number of vehicles. What does that look like? Really, it's the thing that's probably most concerning for us that we watch in the industry is when do showrooms open back up, when -- what is consumer sentiment as it relates to their ability and willingness to buy a vehicle. And we think that's more of the long-term drivers of our business than just auto production itself. What is that consumer sentiment? If you are going to buy a car, what level of car do you buy? How much do you spend on features? What's that average purchase price? Those are the types of things that will really kind of impact our business more than just the raw production levels themselves.

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

That's helpful. And the second question on Gentex is thinking about outgrowth versus the market. I think the initial -- the prior 2020 guidance assumed Gentex revenue grew about 6 points above auto production at the midpoint. And I believe the guidance today is now about 7 points above auto production. So just trying to better understand how you're thinking about your outgrowth versus the market today compared to 90 days ago.

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

Yes. I think it's -- really, it's about the same. I mean, I think the hardest part there is it's such a chaotic environment and the IHS data for vehicle production is changing like drastically literally in the last 3 weeks. The global production dropped about 8 million to 10 million vehicles in the last 3 weeks. So in other words, coming into this year, I think global light vehicle production was 88 million forecasted. It dropped now to 70 million. So it's one of those things that's changing on a weekly basis. And so we're looking at bottoms-up forecast over the next 12 weeks, meaning orders from customers and what our expectations of the business is from a download standpoint from our customer base. But then overlaying that and taking the input from the IHS side for the out-months forecast. And really, it's a pretty modest change between the 6% or 7% outgrowth, but it's right in the range of where we've been the last couple of years.

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

Okay. That's helpful. And just finally for me in terms of your outlook for revenue outside of the auto market. Can you just talk about some of the trends that you're seeing? I know there's some product wins in the commercial plane market, but it's also a new market that's had some challenges. So just any more color on how you're thinking about 2020 for the non-auto business?

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

Yes, absolutely. We're very excited about what we're doing in the aerospace business. It's been a nice growth driver for the company. Definitely opens up some new opportunities for us with all of our technology, not just the dimmable glass. Obviously, that industry has been impacted by this as well. So it's difficult right now for pretty much any production environment. And so it's hard to predict exactly what the impact will be on our customer base from a dimmable glass standpoint in aerospace. Obviously, production what's going on, on commercial construction side, which is really what drives our fire protection industry. A lot of that has stopped or slowed. Currently, our customers are doing quite well. So we continue to ship our fire protection products very regularly. And we're optimistic that, that business will continue to hold up well through the second half of this year. It's really difficult to predict exactly what's going to happen, especially on the construction side because you're talking about local state and local governments kind of controlling what is allowed to and not allowed to happen on the construction side. So unfortunately, that one is even less about the overall economic conditions right now and more about what's legal, what's allowed, what is each state allowing construction companies to do.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Josh O'Berski for any closing remarks.

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

Thank you, everyone, for the questions and your time this morning. Stay safe, and have a great weekend. This concludes our call.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
