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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gentex reports first quarter 2019 financial results. (Operator Instructions) As a reminder, this conference call may be recorded. I would now like to introduce your host for today's conference, Mr. Josh O'Berski, Director of Investor Relations. Sir, you may proceed.

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

Thank you. Good morning and welcome to the Gentex Corporation First Quarter 2019 Earnings Release Conference Call. I'm Josh O'Berski, Gentex' Director of Investor Relations. And I'm joined by Steve Downing, our President and CEO; Kevin Nash, our Vice President of Finance and CFO; and Neil Boehm, Vice President of Engineering and CTO.

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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 2019 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 give the first quarter of 2019 financial summary. Steve?

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

Thank you, Josh. For the first quarter of 2019, the company reported net sales of $468.6 million, which was an increase of 1% compared to net sales of $465.4 million in the first quarter of 2018. This growth was in contrast to global light vehicle production that declined approximately 7% in the first quarter of 2019 when compared to the first quarter of 2018. Additionally, the actual global light vehicle production levels worsened in excess of 3% for the first quarter of 2019 when compared to IHS Markit's mid-January forecast for the first quarter of 2019.

The first quarter of 2019 started off in a very similar fashion to the second half of 2018 with vehicle production forecast being optimistic about growth but with actual results coming in well short of this forecast. A production environment like this obviously makes forecasting difficult and continues to be a reason for our conservative outlook for the remainder of the year.

Despite these vehicle production volume headwinds and certain company-specific product headwinds, our revenue outperformed our underlying markets by approximately 8%. Our growth was driven by very solid performance of the Full Display Mirror which helped us overcome significant volume reductions in our primary industry.

For the first quarter of 2019, the gross margin was 36.2%, which was down when compared to a gross margin of 37.1% in the first quarter of 2018. The gross margin during the quarter was negatively impacted by approximately 90 basis points due to tariffs that became effective in the second half of calendar year 2018.

Our ability to maintain our gross margin profile on a quarter-over-quarter basis, if not for the 90 basis point impact from tariffs, required a tremendous effort from the team to overcome the headwinds created from our annual customer price reductions and the inefficiencies from the slower growth rate. The resiliency in the gross margin was supported by improved product mix during the first quarter of 2019, driven by growth in Full Display Mirror and a 9% growth rate in exterior auto-dimming mirrors.

Operating expenses during the first quarter of 2019 were up 9% to $48 million compared to operating expenses of $44.1 million in the first quarter of 2018. Operating expenses are in line with our stated expectations for 2019 as we continue to focus on increasing our growth rate through additional launches of Full Display Mirror, Integrated Toll Module and additional auto-dimming mirror applications.

Our operating expenses are also focused on new product innovation that will allow us to expand our product portfolio in the areas of connected car, digital vision and large-area dimmable devices. We remain confident in the long-term growth opportunities of these product areas based on the high level of OEM engagement we received at CES in January and that had continued since that time.

Income from operations for the first quarter of 2019 decreased 5% to $121.6 million versus $128.5 million last year. The decrease was primarily due to increased operating expenses and lower gross margin dollars. Other income increased to $3.3 million in the first quarter of 2019 compared to $3.2 million in the first quarter of 2018, primarily due to decreased interest expense.

During the first quarter of 2019, the company's effective tax rate was 16.5%, up from 15.6% during the first quarter of 2018, primarily driven by a decrease in tax benefits related to stock-based compensation.

Net income for the first quarter of 2019 decreased 6% to $104.3 million compared with net income of $111.2 million in the first quarter of 2018, driven by increased operating expenses and an increased tax rate on a quarter-over-quarter basis.

Earnings per diluted share in the first quarter of 2019 remained at $0.40, in line with earnings per diluted share of $0.40 in the first quarter of 2018 as a result of a 7% reduction in diluted shares outstanding from share repurchases. During the first quarter of 2019, the company repurchased approximately 4.7 million shares of its common stock at an average price of $20.37 per share for a total of $96.3 million of share repurchases. As of March 31, 2019, the company has approximately 29.1 million shares remaining available for repurchase pursuant to the previously announced share repurchase plan.

The company intends to continue to repurchase additional shares of its common stock in the future in support of the previously disclosed capital allocation strategy. But share repurchases may vary from time to time and we'll continue to take into account macroeconomic issues, market trends and other factors that the company deems appropriate.

I will now hand the call over to Kevin for the first quarter financial details.

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

Thank you, Steve. Auto-dimming mirror unit shipments increased 1% in the first quarter of 2019 when compared with the first quarter of 2018, which was driven by a 2% decline in interior auto-dimming mirror unit shipments primarily as a result of the 7% decline in global light vehicle production. Conversely, the company experienced a 9% overall increase in exterior auto-dimming mirror unit shipments which was highlighted by a 50% increase in North American exterior auto-dimming mirror unit shipments.

Automotive sales in the first quarter of 2019 were $455.8 million compared with $455 million for the first quarter of 2018. Full Display Mirror and exterior auto-dimming mirror revenue growth was essentially offset by reductions in interior auto-dimming mirror revenue, annual customer price reductions and product-specific revenue headwinds. Other net sales in the first quarter of 2019 were $12.8 million, an increase of 22% compared to $10.4 million in the first quarter of 2018 on increased dimmable aircraft window shipments and increased shipments of certain fire protection products.

Now for a balance sheet update. The following balance sheet items represent a comparison versus December 31, '18, which are also included in today's press release. Cash and cash equivalents were $221.7 million compared to $217 million as of December 31. The increase was primarily due to cash flow from operations which was mostly offset by share repurchases, dividend payments and capital expenditures. Short-term investments were $180.3 million, up from $169.4 million and long-term investments were $126.5 million compared to $138 million. Fluctuations in the 2 were driven by changes in fixed income investment maturities within the portfolio.

Accounts receivable increased $30.7 million to $229 million, primarily due to the higher sales level compared to the fourth quarter of 2018 as well as timing of sales within each of the quarters. Inventories as of March 31 remained consistent at $225.3 million.

Prepaid expenses were $14.9 million, which was a decrease from $25.6 million. The decline was primarily due to reduction in refundable income taxes. Accounts payable decreased $2.7 million to $87.5 million, and other current liabilities increased $16.6 million to $94.4 million primarily as a result of increases in accrued income taxes and accrued wages.

Now for some cash flow highlights. Cash flow from operations for the first quarter of 2019 was $133.8 million compared with $147.4 million during the first quarter of 2018. The change was primarily due to the lower net income and changes in working capital.

And capital expenditures for the first quarter were $16.8 million compared with $26.2 million in the first quarter of '18. And depreciation and amortization for the first quarter was $28.1 million compared with $28 million in the first quarter of '18.

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 first quarter of 2019, there were 11 new nameplate launches of our interior and exterior auto-dimming mirrors and electronic features, net of previously disclosed future headwinds. The first quarter of 2019 launch rate represents a 10% increase over the first quarter of 2018. During the quarter, over 70% of the net nameplate launches contained advanced features led by launches in HomeLink and Full Display Mirror.

Now for an update on our Full Display Mirror products. During the first quarter, we began shipping FDM on the Toyota Hiace, Land Rover Evoque and the Jaguar XE vehicles. The launches for Jaguar Land Rover represent a milestone for the FDM product because they are the first launches with a European-based OEM and include product shipments that will be used for global applications on these vehicles. We believe that the Jaguar Land Rover launches will help push FDM forward with other European-based OEMs in the future.

The launches in the first quarter brought a number of nameplates that we are shipping on to a total of 27. Here is a comprehensive list of the OEMs and the number of nameplates where we are currently shipping FDM.

General Motors, our initial launch customer, has 14 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 6 nameplates. And at Jaguar Land Rover, which was our fifth OEM, we are currently shipping on 2 nameplates.

As we look forward to the balance of the calendar year, we expect to launch [fewer] production on at least 8 additional nameplates through the end of the year, which will put us ahead of our previously stated goal to ship at least 500,000 units of Full Display Mirrors in 2019.

From a new business development standpoint, we are pleased to announce that we have secured our ninth OEM customer for Full Display Mirror business during Q1 2019, and we are optimistic that we'll secure our 10th OEM customer in either the second or third quarter of 2019.

In summary, we are pleased to be able to show progress in the launch and award of additional Full Display Mirror systems despite the difficult vehicle production environment that we are facing. Our latest products and innovations continue to show great potential for growth and revenue as evidenced by the launch cadence and new OEM awards.

I will now hand the call back over to Steve for guidance and closing remarks.

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

Thank you, Neil. Based on the mid-April 2019 IHS Markit light vehicle production forecast for our primary regions of North America, Europe, Japan, Korea and China, our current forecast and product mix and expense growth estimates, the company continues to maintain its previously announced annual guidance ranges in each of the following areas: revenue of $1.83 billion to $1.93 billion, gross margins in the range of 36% to 37% for the year, operating expenses between $195 million and $200 million, estimated tax rate between 16% and 18%, capital expenditures between $90 million and $100 million and depreciation and amortization between $105 million to $115 million. Additionally, the company is maintaining its previously announced revenue guidance for calendar year 2023 to be between 3% and 8% above 2019 revenue estimates.

The first quarter of 2019 was a challenging vehicle production environment, but the company continued to deliver growth that beat our underlying markets by approximately 8%. The organization is working hard to launch products that include features like Full Display Mirror, Integrated Toll Module and other electronic features that are contributing to help us offset the headwinds caused by losses from our older technologies and the negative vehicle production environment.

We are confident in our ability to deliver long-term growth that is driven by our unique technology platforms as we continue to invest through R&D and SG&A to execute the product launches that Neil detailed in his presentation. These important launches are providing growth for this year and 2020 while we fund the new technology platforms that will drive growth for the company longer term. Our focus on operational discipline, combined with our capital allocation strategy, is designed to work hand-in-hand to produce growth and shareholder return, both today and over the next several years.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Chris Van Horn from B. Riley FBR.

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

So I think you mentioned in the past that given IHS' expectations have been a little bit off from what the reality is, you were kind of baking in a little bit more of a conservative view. Are you still taking that stance?

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

Yes. The rest of -- the remaining forecast for the year includes what we came into the year with in terms of adjusting a little bit more off of what IHS is predicting and we made some manual to those. Just given the last 18 months of vehicle production volumes, we believe that there's a little bit more downside bias than there is upside.

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

Okay. Got it. And then are we still seeing the effects of the WLTP in Europe? I know that's a big region for you all. Just curious what you're seeing from a production level over there.

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

Yes. Our -- it's purely speculation at this point. There's not a lot of concrete data available in the marketplace to say exactly what's causing some of the headwinds in Europe. We do believe there are a little bit of remnant issues from WLTP that are affecting especially the first half of '19 from a European production standpoint.

The current forecast from IHS suggests that, that improves in the back half of the year. That's really one of the reasons why we're a little more pessimistic on the IHS predictions, is that we're not sure that the macroeconomic environment is really going to improve that much in Europe in the back half of '19.

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

Got it. Makes sense. And then on the -- I believe you said 70% from advanced features on the launches. Could you get a little bit more color there? That's typically higher than you reported in the past. Was it just kind of an anomaly this quarter? Or is it you're seeing just higher take rates for some of those advanced features?

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

I think it has to do with timing of new launches of some of the new products, with HomeLink and Full Display Mirror being the primary ones. And as we talked about the numbers for the quarter, Full Display Mirror, we had a really good quarter for that product. So not -- I wouldn't say it's an anomaly, but it was a good quarter from a feature set and output to the market. And I don't think it's going to be a constant run rate at that level either. I wouldn't expect that.

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

Well, I think when you look at the production, the -- if you look at the global production issues, the China market being affected the most in this last quarter, that's where a lot of our base mirror launches have been taking place in the last 18 months or 2 years. So when you see that market slow down, you get fewer base mirror launches there, but you end up picking up advanced features in the other markets. So it makes that percentage increase a little more than what it has been.

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

Okay. Makes sense. Last one from me and I'll jump back in the queue. Could you just update us on some of the new technologies you've been highlighting over the past couple of years? The CMS, biometrics, the Bluetooth which have an award with and maybe even the dimmable glass, just some update there?

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

Okay. So I'll -- Neil and I were looking at each other, who is going to go first. So okay, stop. I'm trying to grab the mic, I guess. I will start with dimmable glass. The first concrete award was the one we announced at CES with an aerospace and with the new Boeing program. And so we're really excited and are focused right now on getting that program to launch. Obviously, there's a tremendous amount of work whenever you're launching a program in aerospace. So we have a solid 12 to 18 months ahead of us of hard work to make sure we launch flawlessly with Boeing. But that was the kind of the first remnants of that program or success in that area was with that.

Since that time, what we've been working on with OEMs is we had a lot of request from OEs for large-area devices, prototypes, whether those are incorporated in a vehicle or just something that they can get their hands on and test and understand better, the capability of that product. So what Neil seems -- have been working really hard on since -- he's making sure that we're capable of delivering some concepts and prototypes for the OEMs to do that evaluation.

Quite honestly, walking out of CES, one of the things that's pushing the organization really hard is trying to keep up with that OEM demand for prototypes and proof of concept. So we continue to work hard there. There's a lot of skills and a lot of technical areas and barriers that we have to overcome to get that product into automotive. But we're definitely confident that the demand is there for that type of a solution. So we continue to invest.

When you look at our Full Display Mirror and then the offshoots of that being camera monitoring system, we continue to be very encouraged by the progress we are making for Full Display Mirror. And we believe that once you have that Full Display Mirror technology in place, that camera monitoring solutions, whether they're mirrorless or whether or not they are add-ons to a mirrored solution are really just the next logical step in that product portfolio.

And so Neil's team continues to build the relationships we need from the supplier standpoint and in house to make sure we have that product offering in place. So we continue to see interest in all those areas for the product offering.

The HomeLink side, in terms of connected car and really probably the most interesting that's starting to grow is really the Integrated Toll Module solution. So having that go to market now with Audi in the North American market and have additional -- 2 additional OEMs that have sourced those programs, obviously, there's a lot of work, but -- to get those programs ready for the marketplace. But we're excited about the initial feedback of that product from the OEMs that have seen it and experienced it.

Operator

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

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

So I just want to start on the margin. You had -- usually, 1Q is your softest quarter for margins with the annual price downs. And you're within the guide now, so 36.2% versus the 36% to 37%. So what are some of the risks you see this year that could actually show that being down and to get us to the 36% versus -- it seems now it should be kind of weighted towards the high end of that range.

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

Thanks, Richard. I think the biggest risk that we pose every quarter is the product mix piece. It happened to be that interior mirrors were down, primarily base mirrors as a result of China being weak. So -- and that FDM and exterior mirrors were very strong. So that helps kind of offset the customer price reduction.

Our purchasing performance was a little bit better than we thought kind of going into the year so that also helps. And so we -- I think the biggest risk is really product mix. It doesn't unfold the same as it did in Q1. But right now, we're not seeing major shifts, at least in our forecast, from kind of what Q1 performance was.

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

I'd say the second biggest risk factor would be what happens with tariffs. So I mean, that could be -- it's a risk factor. And if they were to get worse from where they are today, but it also offers some upside potential throughout the year if a trade deal is put in place, we continue to run at that end of '18 run rate for tariffs on an annualized basis. So there is opportunity to improve from here if a trade deal is secured.

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

Yes. Got it. What's actually now built into your guidance for tariffs? Because it should have come down just a little bit with the List 3 step-up not happening, right?

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

Yes. So the run rate is in that $12 million to $15 million annualized based on that. If you remember, we -- what we guided was do $15 million to $20 million total year tariff dollars. And so it's more on that kind of $12 million to $15 million range.

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

Got it. And then with that North American exterior mirror number, I mean 50%, super strong. You've highlighted in the past having a takeover win. Was that all lift because the sequential growth is also impressive? So is there anything else in there helping that?

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

There's been increases in take rates and some additional programs that we've launched and you combine that with the takeover business from a competitor and you produce that 50% kind of growth rate in the quarter. So that's the third quarter I believe now of kind of outpacing growth rate. So we'd expect at least one more quarter of kind of high-level growth rates, and then the year-over-year comps will become a little more difficult. But it's a great book of business, and it definitely, to Kevin's point, has helped stabilize the margin profile.

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

Got it. And then just last one for me for the FDM. What was the actual shipments this year? And what is your -- is your guide still 500,000?

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

The actual shipments for 2018 were 380,000 units. And based on what's going on in the market right now, we're expecting -- between the launches that we -- that I talked about, we expect to exceed the 500,000. But that again is based on take rates, based on the customers that we expect that are launching, will launch at the take rates they say they're going to launch, that the market holds together. So there's a lot of variables there. So we're still staying with our over 500,000 units or -- it's going to be the target.

Operator

And our next question comes from John Murphy from Bank of America.

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

Just a follow-up question on the Full Display Mirrors. When you go in and go through the bid prices on those, do you -- are you finding that you're getting good exterior take rates with them? Or is this something that kind of leads as a single mirror and then ultimately over time, develops into a 3-mirror system?

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

No. Ironically, almost all the awards we have are already 3-mirror system customers. And so it's really about kind of that next step in evolution of vision system for them. In other words, they have auto-dimming capability available in most of their vehicles and they want that enhanced functionality and really, a product that the consumer resonates with. So most of those customers are already 3-mirror system customers or at least have auto-dimming. Some of those customers only offer driver-side auto-dimming currently. But when they do make that step up to a Full Display Mirror, it's usually about the consumer sentiment piece.

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

Okay. And then a same question on Full Display. When you think about sort of fixed cost coverage given the higher price point. I'm just kind of -- I'm trying to understand sort of the manufacturing here. I mean we got to be thinking about much higher margins. But I'm just curious of -- as you think about sort of variable versus fixed on a Full Display versus your traditional interior and exterior dimming mirrors, I mean what's kind of the thought process there?

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

We definitely have higher contribution margin and at a -- on a same-for-same basis. We're typically replacing a base mirror which is a lower price point and a lower gross margin. And so we're getting a lot better coverage as it relates to that. It is a more complex manufacturing process obviously. But so far, margins -- overall margins on that product are in the corporate average range. So it's definitely contributing to the year-over-year improvements in contribution margins.

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

Okay. So should we think about the gross margin, 37.1% ex the tariffs in the quarter versus 37.1% last year? I mean it seems like the margins maybe should have gone up because of mix. Is there something else going on with the margins we should be thinking about or maybe I'm missing?

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

Yes. We had some specific legacy products headwinds that we're -- that we've been talking about quite a bit. The SmartBeam, Driver Assist kind of negative headwinds that are -- builds are -- the SmartBeam fee subscription historically at a higher gross margin. And then just the fixed cost coverage with our overall net growth rate at 1%. We do make our capital investments in automation and equipment. You're not getting any leverage at that 1% sales growth rate.

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

And on a year-over-year basis, especially in Q1, you have your -- basically 85% of your annual customer price reduction start on January 1. So on a year-over-year basis, you got those customer price reductions. Historically, we haven't seen full purchasing benefit until midway through second quarter before we get the full benefit of the price downs from our suppliers. So normally, Q1 is a little more tight than the rest of the year.

And so when we look at treading water basically being unchanged, when you can take out -- ex tariffs, we really feel pretty solid about that and we did get the contribution from that step-up in product mix. Unfortunately, there was the downturn in global production environment that took away some of our interior mirror volume that made that overhead coverage even tougher to accomplish.

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

Got it. And then just lastly on CapEx. I think I heard you right. The number in the quarter I think was $16.8 million. If I got it, had it right, it sounds like that's a little bit below the sort of the annualized run rate you're looking for. Is there just some timing issues here and then we'll see catch-up in CapEx going forward?

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

Yes. We continue to monitor kind of where the market is. And we take a little bit closer approach on individual projects and approvals. And yes, we're running a little bit lighter than the annualized figure. And if the market turns, then we have growth -- outgrowth there, then we'll continue to keep an eye out, but yes...

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

And part of that, years timing. Part of it is just the timing of the projects of when they're happening. And the first quarter was a little lighter. You expect a little bit of an increase throughout the remainder of the year. But like Kevin said, we're definitely -- we have brought down that total CapEx pretty significantly in the last 18 months. Still funding all the projects we need. But we are a little tougher on the criteria for what a payback period looks like and what the financial ramifications are of CapEx.

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

I'm sorry. And how quickly can you kind of turn that on and off? Because I mean your run rate will be a little bit below $70 million, which is quite a bit below what you're talking about for full year. So I mean how fast do you turn this on and off? I mean it seemed like something that will take a little bit more lead time, but it's something you have more flexibility.

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

Well, a lot of it is just about timing of invoices too on capital projects that have been kicked off. So that's why we say you will see some fluctuation from quarter to quarter. We know we have some projects that are kicking off in Q2 and Q3 that will raise that run rate versus what we had in Q1 already. Those have already been agreed and signed off on. It's just about when that equipment gets installed, when it gets delivered to us installed and ready for production.

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

And obviously which just happened. So if there was a slight delay in one -- some of those programs, the CapEx would take longer to be put in place, to be spent, right? I mean that -- I mean it's not something -- I think that's what's going to happen -- up the decks, you have that flexibility.

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

Correct.

Operator

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

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

Just on FDM, can you confirm what the growth rate was in the quarter? I think that might have been mentioned but just to make sure. And then regionally, can you talk about these new customers that you're bringing on here? I think that the ninth customer announced this -- to be announced or announced this quarter and then you got a 10th customer that you expect to close on in the second or third quarter. Is that opportunity in Europe already opening up? Just to maybe get a sense for that.

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

So we're going to stick with the annual guidance as it relates to FDM shipments currently. But reiterating kind of what Neil said, we feel like given all the launches and the activity and the take rates of what we've been seeing so far that we're going to be in excess of the $0.5 million for the year.

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

In terms of naming the OEs, we've been very careful about this because of the -- because how much of the OEMs that have launched with our Full Display Mirror products have used it, part of their marketing of their vehicles. We've been exceptionally careful about mentioning them. So we won't say their names until either they announce it or until they show the product available on their website or on a vehicle or show it at a trade show or a car automotive environment. So we've been steering away from that. What we will say is we have -- we've had a mixture of high volume in those awards from 5, and so what we're projecting to be 10 by the end of the third quarter of this year.

We've had a wide mix of different OEMs who have been involved, luxury-based OEMs, high -- low-volume luxury OEMs to higher-volume OEMs. So what's exciting is that we believe the product isn't limited to niche. It's not limited to the certain high-end vehicles, it is pretty broad-based appeal of a product.

And probably what's more relevant for us and more exciting even is that it doesn't have a geographical bias than a lot of our products have had, i.e., a HomeLink or a Compass product that has traditionally been a North American product, this product truly is a global product. A lot of the OEMs that we've launched with, those OEMs have chosen to launch in what would be 4 markets for us, our export markets, not in the North American market. So it's been exciting to watch this product rollout and get a lot of attention in international auto shows.

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

Got it. And FDM growth in the quarter, is that something you could share?

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

No. We're going to stick to our annual guidance for now.

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

Okay. And then how should we think about the cadence of the Driver Assist and SmartBeam headwind for the year? You previously called out a 200 basis point headwind for the full year. Just curious how that played out in the quarter and what the expectations are related to that one gross headwind.

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

Yes. Given the downturn in production on a year-over-year basis, it's -- that -- the piece of it is about 200 basis points from -- through program loss, probably another 50 to 100 basis points because of the volume losses in the overall market, so call it 250 to 300 basis points all in there.

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

Well, that's what -- honestly, in terms of our total financial performance, that's probably the part that's most exciting about a 1% growth quarter is that we really had 300 basis points of headwinds from product losses plus production in a market that was down 700 basis points versus prior year. So to put up a growth rate inside of that really, strength -- speaks to the strength of our Full Display Mirror and outside mirror launches.

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

Yes. And just last one for me, China, just what are you seeing in China at this point? Are you baking in stabilization in the back half or more of a V-shaped recovery which is kind of the baked in assumption for IHS, high single-digit growth in the back half? I know you do make adjustments based on assumed take rates, curious what you're factoring in there.

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

Yes. Once you get beyond kind of the 12-week window, we're using IHS with a little bit of conservatism. Like Steve mentioned already, we -- our assumptions are the same as what we went into the year with but not necessarily as optimistic kind of with that 1% or 2% kind of overall reduction in all of markets, not just China. But we're -- we continue to monitor it. And I think our assumptions played out fairly well on Q1, and we feel like there's still not major drivers of growth in those end markets.

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

Yes. So if you look at China specifically, really, this kind of pullback in automotive production started at the end of '18, call it early Q3 or mid-Q3 through Q4. And right now, IHS is showing a recovery kind of halfway through Q3 and then quite a bit of recovery in Q4. We would probably be a little more pessimistic about that recovery than what IHS is showing specific to the China market.

So yes, we kind of look at each of these regions. Like Kevin mentioned, we do have the advantage of having 12 weeks of released data for certain areas and certain customers. And so we can use that to help kind of extrapolate where do we think the IHS data is accurate and where do we think it's just slightly overstated for the recovery in China.

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

And in that released data, are you seeing some stabilization on a prospective basis here in China?

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

Yes. What we would see is really more consistent with Q3, Q4 and Q1 going forward into Q2. So we wouldn't -- we were not expecting a huge improvement in Q2 in the China market.

Operator

And our next question comes from David Kelley from Jefferies.

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

Another one on Full Display Mirrors for me. I guess how should we think about the addressable market over the next 2 to 3 years based on your win rate and the European opportunity you referenced? We're just trying to get a better feel for potential FDM and shipment growth opportunity maybe over the medium term.

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

Sure. Well, I think the exciting part is despite the revenue that the product produces, we're only talking about the original guidance only for 0.5 million units this year. So we view the available space. If you look at the number of OEMs who are producing high-end vehicles, large trucks, SUVs, vehicles that this products sits really well with, just from a pure visibility standpoint, not even talking about the consumer sentiment piece, we believe there's at least several million vehicles in the world that this is a perfect fit for. And so we continue to chase and pursue down that path, down the path of a very large available market. And we don't think that we're being overly aggressive in that kind of perspective of what the addressable market is.

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

Okay. Great. That's helpful. And then just to switch gears and looking at the operating expense ramp about -- in line with your expectations. I guess could you speak to the cadence maybe for the balance of the year? Should we expect any quarter-to-quarter lumpiness in either R&D or engineering expense associated with some of the new products or launches upcoming?

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

No. I wouldn't expect a whole lot of bumpiness. I think it will be pretty consistent with that kind of ramp-up rate from -- really, if you look at the beginning of '18, the changes throughout '18 and then into the Q1 of '19, we'd expect that trajectory to continue if not slightly stabilize. So I don't think you'll see a huge amount of lumpiness.

The team is well in place now and we're working through those launches. Anything that does happen that we need outside help with, we tend to contract just to help take the edges off so we don't have to hire 100% of our needs. We can contract some of that, but those tend to be fairly small percentage changes to the overall R&D spend.

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

And then last one more for me and I'll pass along. I know aircraft windows are a smaller business for you. Given one of your customers has been in the news recently, do you see any change in revenue cadence in aerospace?

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

No. In fact, the -- probably the good news, if there is any good news when it -- when dealing with the issues with our customer is that it's not the planes that we're on nor that we're sourced on. So far, it hasn't had any impact in our shipping volume. Our continue -- customer continues to launch this product, get ready for the 777 execution, and we continue to work hard to make sure we're meeting our timing and expectations for that launch.

Operator

And our next question comes from David Leiker from Baird.

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

This is Joe Vruwink for David. On the dynamic where your initial FDM customers started out 3-mirror customers and they've gone to FDM, can you quantify what that's meant generally speaking in dollar terms? So is this $100 of typical content on a vehicle going to 2 to 2.5x that with FDM with these customers?

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

Well, like for our launch customer, Kevin's point was spot on there which is we were replacing -- if you take outside mirrors out of it because they continue to buy outside mirrors. In other words, if the OEM is launching a Full Display Mirror and they're already purchasing outside mirrors, they don't get rid of outside mirrors to add FDMs. So that content is unchanged.

On the inside, however, with our launch customer, they are typically about a $20, $25 average sell price for the mirror that they were buying before FDM, and that bumped up to the $180 to $210, $215 range depending on which product they were buying. So you're talking about an additional $160 to $180 in content with that FDM decision.

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

And does the fact that you had -- some of your initial launch partners are mass market, automakers, the fact that they have $200 to $300 of mirror content on vehicles, has that caused non-FDM customers that are using Gentex to reconsider their own mirror strategies to see other high-profile examples with a lot more content ultimately dedicated to mirrors?

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

Yes. I mean I think it changes their perspective from a technology perspective. The product gets a lot of -- it has gotten a lot of attention at least from consumers and from technology write-ups about automotive, the industry in general and vehicles that are launching with this type of tech. I think the other piece is like, typical for Gentex, is we try to work hard with our customers to provide a business case for them. So we're not talking about $200 in content that they can't get reimbursed for.

Really, what we're pitching to them is not just the product and the technology but also the business case that if we're doing this right and we understand the consumer correctly, that they can buy from us for $160 and hopefully resell those for 1.5 to 2x that price. And so it's not only new and hopefully exciting technology, but it's also a positive business case for them.

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

Are -- is there going to be a situation still on FDM where you're producing simultaneously the different generations of product and does that not create any -- it's a complex product to make to start with. But does that create any additional complexities where the incremental margins for a period of time might be a bit less?

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

Yes. So we're actually shipping our Gen 1 and Gen 2 systems right now. So typical for Gentex as we innovate and create new iterations of this product, I fully expect that we'll be into a Gen 2.5 in the next 18 months to 2 years. And so we'll have all 3 generations at that point shipping at the same time. That's part of the requirement of what we do is we know we need to support the customer and the launches that they've gone through. And so we design our manufacturing system around making sure that we can handle all that complexity.

Now that being said, to your point, as you launch a new product or you change from a Gen 1 to a Gen 2, there are obviously start-up issues and sometimes yield issues that impact profitability. That's so far because of the way we manage that. That has not had a significant impact to our overall corporate financials. We've been able to manage that transition very well. As we're learning through this product, we've also been able to develop Gen 2 to be a more manufacturable product than Gen 1. So, so far, that launch has gone very well on Gen 2 and hasn't had the negative headwinds to margins that we normally see when we launch a new generation of a product.

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

Okay. That's great. And then my last question, and I apologize if you gave this, but can you maybe call out how far below you're assuming production is in the Q3 and Q4? And specifically, there is some questions about Europe. But IHS, I think, assumes you're up gross 5% in Q3. But obviously, there is a new emissions requirement happening in Q3 as well, so maybe just expectations. I think you said no growth or limited growth in Europe. But maybe just explicitly, what you're assuming for end markets.

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

Yes. If you look at the full year, we took -- we didn't kind of quantify it by the entire global production. But we look at certain specific markets, especially China and Europe and we were probably a couple of percentage points worse than IHS when we put together that full year forecast.

Operator

Our next question comes from Anthony Deem from Longbow.

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

A few questions for me. First, is there any update from the WTO on EU's list of duties imported from the U.S.? And with rearview mirrors included on that list previously, I'm wondering how conversations might be going with customers ahead of 2021. And maybe if you see a need to build capacity in Europe or if you're confident you can negotiate past those.

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

Great question. There hasn't been any changes to the list as it did die down obviously last fall when Trump said he had things work out with Europe. But that continues to be an open point. We keep our eyes on the situation and ears with customers. And as you're well aware, Anthony, we have done manufacturing both in Europe and in China historically.

And so the conversations are pretty fluid and there's not been a big push for localization currently. But it's something we continue to evaluate with or without tariffs, what our global footprint looks like. Right now, we continue to feel like doing it here in the U.S. is the best course. But if the customer demand drive that, we'll certainly consider those options. But right now, there hasn't been a big push to the European tariff changes.

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

Got you. And then as we think about it from a capital allocation standpoint, clearly, a lot of focus on share buyback at Gentex which is great. Maybe if you guys don't see a greater clarity or a trade deal sometime soon. I mean what -- could this have implications towards the level of share buyback?

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

Well, I think everything -- when it comes to overall financial performance, everything has the opportunity to affect the level of share repurchases. One of the things we look at is the valuation of the company, what our growth prospects are over the next 2 to 5 years. And as long as we feel comfortable that our growth prospects are going to outperform the marketplace and the stock valuation hasn't moved along with that, then we're going to aggressively pursue that course of action.

At the same time, [M&A front] is -- this is not a thing that we won't pursue M&A activity. Obviously, our criteria for what a good financial deal looks like is probably a little harsher than most. And -- but at the same time, what we love is the hurdle rate for what we compare against it ourselves. And so when we look at the valuation of Gentex and we look at the multiples of EBITDA we're trading at, we still think it's a fair value for the stock.

So we continue to look at all those factors continuously, and those are always subject to change based off availability of targets and assets. And then obviously, if financial performance were to decline or something were to happen, our capital allocation strategy would adjust accordingly.

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

Got you. And I think Kevin, you mentioned you started the year off pretty strong with purchase reductions. Price downs versus purchase reductions, last year, if I recall, I think it was 70 basis point gross margin headwind. I'm wondering what's factored in the guidance for 2019, if any, because we're starting out the year pretty well, it seems.

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

Yes. There still is a little bit of a gap, but the gap has closed. Our teams continue to work on finding sourcing arrangements. And with the market softening a little bit, overall global automotive market softening, it has eased a little bit of a constraint, but there still is a bit of a gap currently between kind of the APR and the purchase cost reductions. It's just that it wasn't as -- I guess it was slightly better than what we were expecting and because of the work of our purchasing commodity teams, sourcing different suppliers in some cases.

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

And some precious metals relief. And so there's been a few factors that, with kind of a global slowdown or at least the beginning of what appears to be a global slowdown, it's taken some of the pressure off the commodities.

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

Got you. And then if I could sneak in one more, please. ER&D line, can you help us get a sense for sort of the budget percentage allocated towards -- and maybe newer next-gen product development versus launch cost, if you're able to share that. And I'm also wondering, the rate of cost inflation, the high single-digit territory, is that consistent across both launch activity and innovation, new next-gen product development?

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

Yes. We -- instead of giving you a breakout of what part goes to there, we'll kind of talk about the strategy and then what's changed in the last 2 years. So -- well, really in the last 3 years. Neil's team continues to grow as we have ideas and capabilities that we want to bring up in the organization. Probably the one that's changed the most is 2 years ago, we started down this course and we launched a whole new series of products from a pure R standpoint that has now moved into more of the D side of the launch phase. And that is ideas like our HomeLink Connect product, our Integrated Toll Module, Full Display Mirror itself and generating that Gen 2 concepts and his team working on Gen 2.5, Gen 3 concepts. Beyond that, we've added a whole new set of things that we're working on that we've shown at CES the last couple of years, so the large-area dimmable devices and the technology leap that we're having to make to try to get those ready for a market like automotive.

And so what you see is the team flexes from one idea to the next and they move with those products. Some of them end up staying with the product and helping it move from R to the development phase into launch phase. Others then get reassigned and move into other categories. Those kind of ebb and flow constantly, and these people are highly talented individuals who are capable of moving and becoming more research focused or more development focused, depending on what phase of execution we're in.

So that's really kind of a continuous changing percentage. And that's why we try not to limit it by, this is what percent is focused on R and what percentage is focused by -- on the development or launch. And so we continue to kind of move and flex people depending on the ideas that are coming in and where we are in the launch phase.

Operator

Our next question comes from David Whiston from MorningStar.

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

Wanted to ask about the whole ongoing discussion of cameras replacing mirrors. And are there any updates to the story arc there in terms of our OEMs still telling you they want the [delivery done, see if] cameras and mirrors -- anything else that's really changed in the past year that you wanted to highlight to the market?

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

This is Neil. I think the -- I'll start and Steve can jump in. I think the -- where the market has gone, if you go back 2 or 3 years ago, there was a lot of noise about cameras replacing mirrors on every car within the next 2 [weeks]. And the reality is the complications of doing that type of system, getting the performance to a level that can compete or actually do well compared to a mirror as well as getting the consumers to accept that type of product is a lot more complicated and taking a lot longer than what was initially anticipated.

I'd say after the first couple of vehicles that have come out in the market now that show it on luxury vehicles on low volume, there's still questions that are being asked in the market. But I would say, a lot of customers have walked away from that being a primary focus of putting engineering and resources into trying to develop that and put their resources more into their electrification and autonomous side versus trying to replace a standard product that they know every consumer can use to put into a digital-only product that some will not use.

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

So we continue to see opportunities in that space for Gentex to participate. And so we continue to refine that, the skill set. We've actually been active in bidding in a couple different OEMs in the last 18 months, a couple of which have decided, despite the fact they started a [cold] phase, decided to push back or delay, if not cancel, that execution.

Like Neil mentioned, because of the concerns and the things we've always talked about are concern factors, we viewed it and our business case has been around -- built around the fact that we can expand our FDM lineup and offer additional electronic technology and hopefully build the business case for the OEM. And I think that's a big part of the OEMs that realize that without a business case, this is incredibly difficult, expensive technology that the consumer isn't -- if a consumer's not pulling it, then it's going to be a cost that you're carrying with very low upside benefit. So we continue to try to work on our product offering to be able to meet all those questions, including the business case.

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

Okay. And just to follow up on the earlier buyback question. Is it fair to say as long as you still have plenty of cash on hand, you'd be pretty aggressive even in a recession?

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

Correct. Yes. If you look at the cash, the cash, cash equivalents and the short and long-term investments, those are all fixed income, either -- they can all be turned into cash very quickly. And so we continue to be very well positioned in our cash position. We also have access to a line of credit. And obviously, we stay focused on trying to make sure we're generating cash off of our existing business appropriately. We believe, with all those factors, that we're well positioned to move if the market price were to retrench to where it just doesn't make sense anymore or at the same time, that flexibility gives us opportunities for companies outside of our own if M&A targets become available at favorable pricing.

Operator

Our next question comes from Ryan Brinkman from JPMorgan.

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

As you gain more and more traction with the Full Display Mirror, have you started to see on the horizon any competitor products to try to cut into this area of yours? Do you think competition for FDM is being simply a system of cameras and displays? Or are there others attempting to replicate your approach of offering an auto-dimming mirror that can additionally serve as a system of cameras and displays?

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

There's been quite a few people that have shown competitive type products. We believe our track record, our reliability, the unique physics problem that needs to be solved by having a reflective surface but yet a display shining through that is not a simple one to overcome and we've spent a tremendous amount of time on it. This didn't happen in the last 2 years. We've been working on these transflective coatings for the better part of 15 years. And so we took every bit of that amount of time to get it to the state it's at today. And so we believe there's -- from a technology standpoint, we have some advantages. We believe, from a scale standpoint and from a cost competitive standpoint, we actually have some advantages.

So to stand here today and say that I thought 3 years ago that we'd have 10 OEMs that we think we'll have secured by second or third quarter, I didn't think it would move this quickly. I certainly thought that we would have had lost a couple of programs. And our market share, if it were 70%, 80%, would still be very competitive. And our primary markets, we'd say that our market share is actually better than that, and we feel good about where we're at from a competitive standpoint. It doesn't mean we're without a competitor. That's not what that means. It just means we feel like our product offering is unique enough that it positioned us well to make a total business case to the OEM that makes sense.

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

That's helpful. And then just lastly, what is the latest you're seeing with regards to whether vehicles are capable of being driven in fully autonomous mode, will have mirrors. So at the Tesla Autonomous Investor Day on Monday, they mentioned increasingly leaving components off of vehicles such as pedals and steering wheels, et cetera. Is this locally in your view? Or do you think that robo-taxis and other autonomous vehicles might, for a long time, still have the ability to be driven by humans, at least when necessary, with more positive implications for mirror shipments?

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

Well, the -- that's -- our position is that the market will bifurcate once there is fully autonomous vehicles available. The concept of a robo-taxi being -- without those types of -- that type of functionality probably makes sense. The concept that a high-end luxury OEM is going to produce a car without those features doesn't necessarily make as much sense to us. And the reason why is that you as an individual, you may want to drive your car sometimes, maybe not all the time, maybe there's moments where you want it to be fully autonomous.

But that ability to choose as a consumer is really what drives a lot of the marketplace on the consumer electronics side all the way up through automotive. And so we think that there's a use case for fully autonomous where you can't control that vehicle at all for a robo-taxi type environment. But we believe there will be different OEMs that take a very different approach as it relates to wanting that functionality available so that you would, the consumer, if you want to put it in fully autonomous mode, you can.

But it will be a completely different environment if you want to drive that vehicle sometimes. And there's still people that enjoy having that control, that still enjoy the experience of driving. And quite honestly, if you're talking about high-end performance cars or even the high-end luxury vehicles that allow you to have some control, we think there's a redundancy there that's important. There's also the ability for the consumer to choose that mode that's going to become very marketable for OEMs going forward.

Operator

And I am showing no further questions from our phone lines. I'd now like to turn the conference back over to Josh O'Berski for any closing remarks.

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

Perfect. Thank you, everyone, for your time this morning. As a reminder, we will be hosting our Annual Shareholder Meeting on May 16, 2019. And our Analyst and Investor Day this year will be on August 21, 2019. If you'd like more information on attending either of these events, please feel free to contact me after this call. We look forward to seeing many of you there. Thanks and have a great rest of your week.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.
