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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gentex Reports Third Quarter 2018 Earnings Call. (Operator Instructions) As a reminder, today's conference may be recorded. I would now like to turn the call over to Mr. Josh O'Berski, Director of Investor Relations. Sir, you may begin.

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

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

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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 Third Quarter 2018 Financial Results press release from earlier this morning and as always, shown on the Gentex website. Your participation in this conference call implies consent to these terms.

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

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

Thank you, Josh. For the third quarter of 2018, the company reported net sales of $460.3 million, which was an increase of 5% compared to net sales of $438.6 million in the third quarter of 2017. When compared with IHS Markit's mid-July forecast for the third quarter of 2018, actual light vehicle production was approximately 5% below forecast in our primary markets of Europe, North America, Japan and Korea. In addition, when compared to the third quarter of 2017, actual vehicle production declined by approximately 3% in our primary markets.

The lower levels of vehicle production were primarily impacted by WLTP regulations in Europe, which resulted in unit shipments and revenue that were below forecast for the quarter.

The third quarter of 2018 began with vehicle production estimates pointing toward near double-digit revenue growth for the quarter. But actual vehicle production levels, as we mentioned earlier, came in considerably lower than anyone expected. Despite the difficult production environment, we are pleased with the 8% outperformance versus our underlying markets, which was driven by growth in our core auto-dimming mirror business and launches and ramp-up in production of our Full Display Mirror.

For the third quarter of 2018, the gross margin was 37.6%, which was down when compared to a gross margin of 39% in the third quarter of 2017. The gross margin during the quarter was negatively impacted by approximately 60 basis points due to the tariffs that became effective during the quarter.

A detailed review of the gross margin performance in the quarter reveals a couple of interesting data points. First, the gross margin performed well during the quarter when accounting for the poor performance in vehicle production, which resulted in lower-than-expected revenue growth.

Second, when you consider the 60 basis point headwind the company experienced from the addition of tariffs, the gross margin during the quarter would have been 38.2%. Net of these new tariffs, the gross margin for the company improved sequentially during each quarter of 2018.

Operating expenses during the third quarter of 2018 were up 8% to $45.6 million when compared to operating expenses of $42.2 million in the third quarter of 2017, primarily due to increased staffing levels. Income from operations for the third quarter of 2018 decreased 1% to $127.4 million when compared to income from operations of $129.1 million for the third quarter of 2017, primarily due to increased operating expenses and lower gross margin percentage, which was partially offset by quarter-over-quarter sales growth. Other income increased to $3.1 million in the third quarter of 2018 compared to $1.8 million in the third quarter of 2017, primarily due to decreased interest expense and higher investment income.

During the third quarter of 2018, the company's effective tax rate was 14.7%, down from 31% during the third quarter of 2017, primarily driven by the impacts of the Tax Cuts and Jobs Act of 2017 and the tax planning initiatives undertaken by the company.

Net income for the third quarter of 2018 increased 23% to $111.3 million compared with net income of $90.2 million in the third quarter of 2017. Earnings per diluted share in the third quarter of 2018 increased 35% to $0.42 compared with earnings per diluted share of $0.31 in the third quarter of 2017 as a result of the lower effective tax rate and a reduction in diluted shares outstanding on a quarter-over-quarter basis.

During the third quarter of 2018, the company repurchased 7.5 million shares of its common stock at an average price of $22.98 per share for a total of $172.5 million of share repurchases. As of September 30, 2018, the company has approximately 12.2 million shares remaining available for repurchase pursuant to the previously announced share repurchase plan, which remains a part of the company's broader publicly disclosed capital allocation strategy.

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

During the third quarter of 2018, the company paid down the remaining principal in its credit facility of $23.1 million. The company recently entered into a new credit agreement for $150 million senior revolving credit facility that will mature on October 15, 2023.

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

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

Thank you, Steve. For the next few minutes, we'd like to spend some time discussing additional details of the third quarter, key factors that drove the results and points of consideration as we move through the remainder of 2018.

Automotive net sales in the third quarter of 2018 were $449.2 million, an increase of 5% compared with automotive net sales of $428.2 million in the third quarter of 2017, driven by a 6% increase in auto-dimming mirror unit shipments and Full Display Mirror launches and volume increases on a quarter-over-quarter basis.

Other net sales in the third quarter of 2018, which includes dimmable aircraft windows and fire protection products, were $11.1 million, an increase of 6% compared to other net sales of $10.5 million in the third quarter of 2017. As we disclosed in our capital allocation press release in March of this year, one of the primary focuses of our strategy was a reduction in our target balances for cash and investments to approximately $525 million by the end of calendar year '18.

As we discussed during our previous calls, our approach is going to be part systematic and part opportunistic. As of September 30, 2018, the combination of cash, short-term and long-term investments were $479.3 million, down from $779.9 million as of December 31. The primary drivers of the overall reductions were also part of the same capital allocation strategy, which included increased share repurchases and accelerated debt repayments in addition to capital expenditures and an increase to the company's dividend rate earlier this year.

The current mix between cash and investments may change on a quarterly basis related to changes in liquidity requirements, fluctuation in interest rates and fixed income investment, maturities and reinvestments.

Accounts receivable was $247.3 million as of September 30, up from $231.1 million as of December 31, primarily due to higher sales levels on a period-over-period basis. Inventories were $213.4 million as of September 30, down from $216.8 million as of December 31. Accounts payable were unchanged at approximately $90 million as of September 30. Accrued liabilities were $82.8 million as of September 30, down from $153.8 million as of December 31, driven by accelerated debt repayments.

Now for some cash flow highlights. Third quarter 2018 cash flow from operations was $105.8 million compared with $90 million in the third quarter of 2017, driven by increased net income and fluctuations in working capital. Capital expenditures for the third quarter of 2018 were $16.9 million compared with $29.9 million for the third quarter of 2017. And lastly, depreciation and amortization for the third quarter of 2018 was $24.8 million compared with $24.4 million in the third quarter of 2017.

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

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

Thank you, Kevin. To begin with, I'd like to provide an update on our launch activity this past quarter. In the third quarter of 2018, there were 19 net new nameplate launches of our inside and outside electrochromic mirrors and electronic features. This launch freight was led by our outside auto-dimming mirrors, HomeLink and Full Display Mirror launches. Our outside auto-dimming mirrors had a very strong growth rate of 6 net new nameplate launches. This level of launch activity is tied for the highest outside mirror launch cadence in the last 2 years.

During the third quarter, the company once again experienced increased launch levels in HomeLink and Full Display Mirror applications. For the quarter, we launched 8 net new HomeLink applications, which is the highest HomeLink launch cadence since we acquired HomeLink in 2013. Also for the quarter, we continue to see growth in Full Display Mirror launches that we've been discussing over the last few quarters. This was highlighted by 5 new Full Display Mirror launches in this past quarter.

The final launch data point we'd like to discuss covers successful launches for domestic China OEMs. In Q2, we announced 4 new launches into the China market. And during Q3, we had an additional 3 launches of our inside and outside auto-dimming mirrors with domestic China OEMs.

Now for a more detailed update on our Full Display Mirror product. At our analyst and investor presentation in Manhattan this past August, we announced 3 new vehicles that now have Full Display Mirror applications. The new vehicles are the GMC Sierra, the Chevy Camaro and the Toyota Crown for the Japan market.

Now we'd like to provide an update on additional vehicles that are now offering our market-leading Full Display Mirror technology. We're excited to announce that the Cadillac XT4, the Subaru Forester for the Japan market and the Lexus ES for the Japan market are all currently in production with our Full Display Mirror. In the Q2 conference call, we discussed that our launch cadence would have us shipping Full Display Mirrors on at least 6 additional nameplates through the second half of the year.

To summarize, we announced 3 new nameplates in August and an additional 3 new nameplates today, which means by the end of Q3, we have already accomplished our goal for the entire second half of the year. Based on this, we're ahead of schedule with our forecasted launches for the year and are on pace to achieve our target of 500,000 Full Display Mirror unit shipments in calendar year 2019. Full Display Mirror continues to be well received by our customers, and we estimate that we will receive an additional award from an eighth OEM sometime toward the end of 2018.

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

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

Thank you, Neil. The company's forecast for light vehicle production for the fourth quarter and full year 2018 are based on IHS Markit's mid-October 2018 forecast for light vehicle production in North America, Europe, Japan and Korea. Based on the IHS Markit light vehicle production forecast, current forecasted product mix and expense growth estimates, the company has updated certain of its 2018 guidance which was included in our earnings press release from this morning.

For the fourth quarter of 2018, the company estimates that revenue will increase between 3% and 7% versus the same quarter last year. As a result of the recently enacted tariffs by the Office of the United States Trade Representative related to imports from China and tariffs enacted by China on imports from the United States, the company currently expects additional cost increases of between $2.5 million and $3 million for the fourth quarter of 2018.

Total cost increases related to all enacted tariffs are expected to be approximately $5.5 million to $6 million for the fourth quarter of 2018. These cost increases are expected to negatively impact gross margin and are reflected in the company's updated margin guidance provided. The company continues to monitor and evaluate the impact of such tariffs, along with other potential import and export tariffs that may be implemented by other countries, which may have application to the company's raw materials and/or finished products.

As we move into the fourth quarter, we are expecting to remain in a tough light vehicle production environment due to ongoing regulation issues in Europe and vehicle production levels that so far this year have been lower than the industry expected. Overall, we remain optimistic that the growth of our core auto-dimming mirrors and Full Display Mirror launches will continue to provide growth rates well above vehicle production levels over the balance of 2018 and through calendar year 2019.

Additionally, we will continue to work hard to offset the cost increases from the newly enacted tariffs. We continue to believe that our sales and margin performance throughout the year, in combination with the execution of our capital allocation strategy, has produced the results we were expecting but that the market has not fully valued. We remain confident that our execution of the strategies we have put in place will continue to create value for our shareholders.

In closing, we will be exhibiting at SEMA from October 30 through November 2 and at CES from January 8 through 11. As always, please know that you're welcome to come see us at the show to experience our products and to see the progress we are making with our new technology. If you're interested in visiting us at either event, please feel free to contact Josh O'Berski to schedule a time.

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

QUESTIONS AND ANSWERS

Operator

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

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

I just want to focus on tariffs a bit. Was it one product category that's really driving that or is it multiple? And then can you comment on the concept of alternative sourcing? And then how do we think about these tariffs going forward as we head through -- as we head into 2019?

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

Thanks, Chris. The primary impact in the third quarter was mostly from this one that was published on July 6, which is heavily electronic content and wire harnesses, things of that nature. List 2 to impact in mid-August. And so that was -- originally, we talked a little bit higher about that, but that one was a little bit less than we originally estimated. And then going into Q4, List 3, as you know, was effective on September 24 at 10% and that does jump up into 2019. So we're not limiting the impacts of that right now. Our engineering and purchasing teams are working through kind of scenarios on how we can resource. And I think we feel like there's some opportunities there. But some of that stuff is short run in nature. And so Q4 really is kind of doing what we've been doing.

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

And so Chris, if you look at the -- all 3 lists, you're going to cover everything from basically any type of electronic subcomponent, small parts to displays. Pretty much anything on the electronics front is in purview of the tariff list.

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

Got it. Got it. Great.

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

Then one quick last one is that China did -- retaliated, so some of our finished goods going into our distribution center into China are going to be impacted in the fourth quarter as well.

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

Okay. And that's all in the guidance?

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

It's all contemplated, yes.

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

Yes, okay. Great, great. So ex tariffs and despite this lower production environment, the gross margins are still pretty strong. I mean, I think there's a thesis that gross margins with the lower production would be hit. So could you -- was -- is the 30% growth in exterior mirrors in North America helping that? What was really the driver of your ability to do that?

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

Well, you look at a couple of factors. Like we talked about, really, well, starting at the midpoint of the year this year, we finally had a full benefit from our purchase components from our suppliers. So we got a full flow-through of that. You look at the growth rate in the business and you see the strong growth in outside mirrors in the second half, and those are all contributing factors to the margin expansion net of tariffs.

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

Okay, got it. And then sorry, just could you comment on that 31% growth in exterior mirrors in North America, anything big driving that? It just seems like a big number.

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

Yes, there were some takeover programs that we experienced that launched in Q3 that helped that growth rate expand and then some -- obviously, some new vehicles coming online in production during that as well that helped that growth rate.

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

And if you also remember, last year, Q3 was extraordinarily weak on outside mirrors in North America.

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

In North America, yes.

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

Yes. Got it, okay. Last one for me, I'll jump back in the queue. Obviously, Full Display Mirror continues to track really well, a number of new launches. Could you just give us a sense of the customer feedback and what you're hearing on take rates and how the impact of Full Display Mirror is going from a customer perspective?

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

Chris, it's Neil. In general, the Full Display Mirror product across the customer base is -- continues to grow interest from a consumer side as well as from the OE side. I think take rates are probably -- depending on the vehicle, you're anywhere from 20% to probably 40%, would probably be a pretty reasonable average. On some vehicles, it's a little higher. I guess, the consumer side feedback, the technology continues to change and evolve. One of the things that we look at from our advantage is how quickly we can continue to make that product even better than what it was before. And you'll see that in some of the new launches that came out with our Generation 2 product. It's a much more aesthetic product and it's -- the feedback from the consumer and the customers on it has been really, really positive.

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

Got it, got it. And then sorry, just a quick follow-on. Could you comment on, if any of the programs are camera and display versus just the display portion?

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

The new ones that we talked about are mostly display only. I think there is the one that is the camera, that would be the Subaru, is the camera and display. The other ones are all display only.

Operator

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

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

So just the 3% to 7% growth for 4Q, I mean, it seems a little wide for as much visibility as I think you'd probably normally have for the quarter. So maybe you could talk about the -- some of the puts and takes that would get you to the 3% and the 7% range?

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

Sure. I mean, the reason for the wider range this quarter, quite honestly, is what we've seen in Q3 and really throughout this year, and that is there's been a lot of customer order changes at the last minute, especially in the last 3 to 6 months. And so we're really looking at kind of what we feel like the forecast is and then looking at that variability that we've seen over the past 3 to 6 months and saying, "Okay, we need to paint a picture that's reflective of what we've experienced."

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

Got it. And then I guess, at this point, are you expecting some perhaps benefit in 2019 from some of the European recovery?

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

We hope so. I mean, that's the million-dollar question, I think, is -- is this a onetime event that's going to recover and push orders into Q4 and '19? Or is this an opportunity for everyone to adjust to where demand is? I -- most indicators lead that there should be some push out and pick up some of this volume between Q4 and Q1 or sometime into '19, but we are not going to count those chickens quite yet.

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

Got it, got it. And then on the share repo, I mean, very strong this quarter and your cash, your net cash is now below that target $525 million range. I mean, just looking at where your shares are now, currently priced and choosing the valuation range, you guys get a little bit more aggressive. Could we see you guys bring that $525 million down a little bit more?

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

Yes, I think it's fair to say that the $525 million was the target and that we are going to be situational with share repurchases. And obviously, given the price that we are trading at right now, we do believe that the company is undervalued versus what our projections are for '18 and '19. You see a little bit of gross margin pressure and a little bit of risk from the tariff side. But all in all, you look at a 23% step-up in net income, a 35% increase in EPS and you model that out over '18 and into '19 and then you look at our historical PE and I -- we look at this valuation and it just doesn't make sense. We think some of the concerns are here overdone.

Operator

And our next question comes from the line of Rich Kwas with Wells Fargo Securities.

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

Just putting on a finer point on the tariffs. So it looks like Lists 2 and 3 were an incremental $3 million at least on a quarterly run rate, so $12 million on annualized rate at 10%. Is that the right way to think about it?

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

Yes. The step-up from Q3 to Q4, that's a fair assumption, yes. And then remember, List 3 goes up on January 1 as well.

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

Right. So is kind of the worst-case scenario that you just multiply that by 2.5x and with no offsets and that will be the full impact that you would had to incur?

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

I think, what we're -- what we've been working on and what we've already modeled really kind of right now, we feel like our worst-case scenario is in that $25 million to $30 million range for 2019. Because some of the things -- we have done some things already. So List 3 may not be as impacted in Q1, but we're working on a few other things that we think we can accomplish. But worst case, we think $25 million to $30 million is probably, if you ballpark that, that's what we're modeling for our forecast.

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

And that's assuming that we can't find any offsets.

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

Yes.

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

Right, right. So that encompasses all 3 lists and encompasses List 3 to 25%, correct?

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

Yes, that's correct.

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

Okay, all right. And then just a couple of others on '19. I know you're ways out from giving more specifics around '19. But if we take the 5% to 10% and given where the current mix is within that 5% to 10%, if we strip down the tariffs, how should we think about gross margin in '19 if you look at it on a "core basis"? Would there be expansion there if you excluded the tariffs on that mix of the 5% to 10%?

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

Yes, I think if you stripped out the tariffs, I think we'd assume margins roughly in line with 2018 margins.

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

Okay, all right. So in line on a core basis and then you have to factor in tariffs, okay. And then the CapEx adjustment lower. Just curious, was that a push out or is there something more structural there in terms of what you're spending on?

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

No, just looking at it, I mean, the first half of the year was a little higher. We are building a new distribution center. We had some other spending that happened. But really, we're very tactical in terms of project base and in terms of CapEx. So basically, we look for a business case and everything, and the quarter was a little lighter than we had anticipated and we're still funding the business appropriately. So we feel good about that lower level of CapEx for the quarter, and we'll continue to fund the business appropriately. But it would just turn out to be definitely a downturn -- a downtick, I should say, in the spending on CapEx for the quarter.

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

Would that some of that go fall into '19 then?

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

Yes, some of it could push out a little bit into Q4 potentially and some into '19, but not all of it.

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

And then just...

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

I don't think you'd see a step-up from, like what we've talked about before, modeling it around kind of our forecast on our sales growth and like Steve said, on a project by project basis to run the business.

Keith R. Schicker ***Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst***

Anything you're seeing from the customer base around delaying programs or adjusting the scope of programs at this point?

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

No, it's actually interesting. I mean, when you look at it, we would use kind of the HomeLink and Full Display Mirror and outside mirror launches in the quarter as pretty good indicators. The immediate concern obviously when it starts to happen is, like you mentioned, you start to see evidence of a pullback or downturn. But in reality, our launches were very strong in Q3. And those tend to be a pretty good indicator of the next several years of what we're expecting on the business side. So right now, we're feeling pretty good about where we're at with the product cadence launch and how those are ultimately moving from launch and into volume.

Operator

Our next question comes from the line of David Leiker with Baird.

David Jon Leiker ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

If we look at your -- the numbers that you put up here, it looks like, obviously, the build number was a little bit lower. But it looks like your growth relative to the market actually was better. Can you talk about what's behind that a bit?

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

Yes, I think it's just indicative of, right now, we feel like our products are right. The customers are interested in them and then the launches are pretty strong. So there obviously has been a lot of talk about how do our features hold up and -- as the vehicles are changing and we see strength in that. If you look at our core auto-dimming mirror business, it's still growing very successfully. We're excited about those growth rates outside of our traditional markets. So if you look at the domestic China market, we've kind of pointed that out the last 2 quarters to help drive [home point] that we see growth opportunities in the China market even though the China market may not be performing as well as it had in the past. And so when you look at the combination of the new technology like Full Display Mirror and then good growth in our core auto-dimming business, we feel like we're positioned pretty well for growth.

David Jon Leiker ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay, great. And then if we look at some of these newer products, the more -- your advanced technology products, Full Display Mirror in particular, it seems like the Japanese market, local market is more aggressive in kind of -- in bringing this to the customers than others. I'm just curious, any thoughts behind what drives that?

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

Yes. This is Neil. There's a couple of different factors that get into that. In the Japan market, what -- as you noticed, obviously, there are Japanese manufacturers launching. They wanted to launch that in a local market in order to help support the execution to their consumer based on the ability of the dealers to help provide a different service and what they did in other regions. But if you look at General Motors with Cadillac, I mean, that's predominantly a North American launched system with -- and the Chevies as well in the U.S. with some exporting. So I think we're spread out pretty well. But yes, some of the recent launches have been for the Japan market, but that's been more controlled based on where their dealers are located and their control of their dealerships are.

David Jon Leiker ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. And then just one last item, just to follow-up on kind of the take rates, which you did a great job of discussing. I'm more curious how the product is being packaged for the consumer to be sold to the consumer and what that cost to the consumer looks like across the different customers.

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

If you look at it, the packages are always tricky. But if you look at GM, typically, if it's on a full-sized SUV or on a Cadillac-branded vehicle, there's usually anywhere from 3 to 4 different trim packages on those vehicles, and we tend to be -- if it's 3, we're probably going to be standard on the top and then optional on the middle. If it's 4, we're probably going to be standard on the top and optional on the second and maybe even the third. In terms of standalone features, it's a little tougher. You can build certain GM vehicles and ultimately find Full Display Mirrors with standalone option and those tend to be priced anywhere yielding a $400 -- yes, about $350 to $450 range.

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

Yes, $475 is what has been in some of the Cadillacs, and it just gets tied with different technology packages. So depending on the vehicle and the manufacturer, they tie it in differently.

Operator

And our next question comes from the line of Anthony Deem with Longbow.

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

So just a few. First, I appreciate the color on the gross margin outlook for 2019. I was wondering if you can give us some color on your operating expense growth outlook for 2019. It's been pretty similar to your prior commentary. I'm just wondering if additional staff you've added here in '18 is sufficient, support the new business you sourced and are pursuing or maybe we should expect another year of catching up from our personnel and cost standpoint next year?

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

Yes, I mean, our goal is obviously to try to keep total OpEx roughly in line with sales growth. But know that some of the new technologies that we're investing in and some of the new things we're working on, you might see that be slightly higher than the growth rate but not significantly higher. And so if you look at kind of the top end of that growth rate range, that will probably be what our target is for next year.

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

Okay. So maybe we should model 10% operating expense growth next year?

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

If you did, that would probably be pretty conservative. That's probably -- on the R&D especially, it should be up there, the SG&A hopefully will be more in line with just sales growth. But the weighted average will be a little bit towards the top half.

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

Thanks, I appreciate that. Secondly, so you're clearly having some success in China bidding. I'm wondering, how do you see your revenue progressing over the coming years versus underlying production? Do you see the China market trending in line with corporate average growth versus market? Is it better or worse? Any color is appreciated.

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

Yes. If you look at it on a percentage basis, I mean, one of the things we haven't really done over the last couple of years is really give that color quite as well as we should have, so we're trying to do a better job of that now. If you look at the growth rates in China, it's been far above the corporate growth rate average really over the last several years. And so we -- as the market starts to slow down there a little bit, we still believe that it will outpace the normal corporate growth rate by a pretty wide margin.

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

Got you. And I apologize if this is addressed in a prior question. But on Japan, do you view that this camera-based side feature content as niche? Or -- and is there strong take rates early on from maybe what you've observed? EC penetration is pretty well in Japan from what I understand on a relative basis versus other mature markets. So I'm just wondering if the EC mirror penetration growth is still very significant or if you see there's emerging risk as material headwinds?

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

Well, I think, in the e-mirror side of the business on Japan, we view that as more of a niche application. If you look at how it's executed, what we've seen is consumers tend to find it interesting, but the execution isn't as robust as what we believe needs to happen. So one of the things that we're focused on is try to provide a solution that matches the needs of the driver today and what an OEM is looking to do for the future. That's why we believe our hybrid solution that we showed at CES last year is a superior execution. That doesn't mean OEMs are going to try lower volume applications. Our first take of what we understand about that vehicle in particular is that those take rates are incredibly low and obviously, it's only available on the Japan market. So one of the things that we're focused on is trying to show alternative products that are -- offer up the same type of functionality in a more robust design.

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

Okay. If I could sneak one last one in here, reasonably large cut in the CapEx here. Can you provide us with some color on some of the projects that you cut back on? Or is this more of a reflection of weaker and near-term backdrop in production or maybe related to some of your long-term opportunities?

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

Sure. Yes, there's no fundamental message being sent there with that CapEx reduction. All that is, is really for us as we build our projects based off of -- and obviously, the largest things that move CapEx in any quarter are brick-and-mortar projects. We've been working on one at our new distribution center. It's actually opening right now and we expect to be operating out of that during Q4. Beyond that, what we are really doing is kind of modeling out the entire year, and then every CapEx project obviously has a return analysis associated with it. And so as projects come up, we're looking at the financial benefit of those projects. And if they make sense, we do them. It's not about a lack of demand. It's really about we front-loaded the first half of the year a little bit, and we're able to take a little bit of a breather in Q3 and probably go back to our normal pace in Q4 and into '19. So there's not any lack of demand that's driving that reduction. It's more just a tactical approach to making sure we're spending money appropriately.

Operator

(Operator Instructions) Our next question comes from the line of John Murphy with Bank of America Merrill Lynch.

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

A lot of my questions have been answered, but I've got 2 sort of unique ones. First, on the Lexus ES in Japan, that vehicle, it sounds like you've got Full Display Mirror, but the side view mirrors have been replaced with cameras and display. So I'm just curious, as you think about that progression, the move some -- for some automakers to cameras and displays, what sort of the content opportunity is on vehicles like that? And as we sort of see this replacement, will we still see the Full Display Mirrors in the middle of vehicles as far as you understand?

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

Yes. The Lexus ES is a very interesting example. So first, kind of just to make sure everybody understands what that -- and not everyone might have seen the announcement on that vehicle. But we have a Full Display Mirror application available on that vehicle, and it's actually on several different trim levels for that car. The e-mirror system is provided by a different supplier, and that basically removes outside mirrors and replaces it with cameras and displays on the pillars. And basically, our product has a higher penetration and take rate than that e-mirror system. That e-mirror system, based off what we understand so far, is expected to be incredibly low take rate and volumes. We believe -- and obviously, it's an expensive system. When we look at our take on that vehicle, we've executed similar prototypes and POCs following that type of model. We do believe there's some significant limitations in drivability and usability for the consumer, and that's why we've developed our hybrid solution as an alternative to that. There is a tremendous amount of upside obviously if this type of digital or hybrid system were to take place and that's why we're investing in that product and then trying to show an alternative that we believe is more consumer-friendly. I'm not discussing there, John, that I...

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

Yes, so if you think about the big content potential and margin potential and something like that for you, I understand that you guys don't have the outside e-mirror system on that vehicle. But if you saw that kind of system come into play, is that a big content positive for you and potentially margin positive?

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

Sure. So our -- what we've seen so far is that someone going to this type of model tends to view our Full Display Mirror as kind of the center point of that. And so assuming that we already had Full Display Mirror, the incremental content for e-mirror system for us, you'd look at probably about $50 per camera. And then depending on how the OEM wanted to execute graphics processing, there could be another $30 to $50 in content depending on how much video processing they wanted to accomplish or manipulation of that video image.

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

Got it, okay.

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

And that's just the incremental piece of it.

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

And then -- I'm sorry, that $30 includes the small screens that go along with it. Is that correct or no?

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

No, that's just the cameras. The screens themselves, if you add those, would probably be another $50 per display, I would assume, or more.

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

You said $50 per camera. It's $30 for the image processing and then it's another $50 for the screens? Is that...

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

Yes, probably $50 to $75, depending on how big of a -- screens they wanted to use for the displays.

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

Okay, that's very helpful. And then just the second question. I mean, as you will get what's going on with tariffs around the world and there's some extreme uncertainties still based on all the noise, what we're all hearing, I mean, is there potential for you to establish another manufacturing base either in Europe, in China for your mirrors to deal with those long term?

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

Yes, absolutely. I mean, when we look at how we respond to our customers, we know it's imperative that we deliver a product to them that's cost-effective and build a business case for them. So given how new this is and how early on in the cycle we are, our position right now is we've been studying and looking at alternatives to make sure we're prepared to make that decision if and when it needs to happen. We're just not that -- at that point yet. We still believe there's a period here that this may get negotiated and settled in a more favorable way if that happens. Obviously, it will be the most efficient or cost-efficient for us to have been a little patient. So what we would do is we work on modeling the plans and we prepare. And if this looks like it's going to continue for an extended period of time, then we'll have to look at alternatives.

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

Okay. And I apologize, just last question. When you look at what happened with schedules through the course of the quarter, like when we started, when you're looking at this April, May and June, how fast did the schedules change? And how different were they versus your original expectation because I think there's kind of a view that we certainly have and most folks have that the quarter started up looking like you were going to be up 4% globally and this is the global IHS numbers, but it looks like it finished down 2%? I'm just curious, when you look at sort of the runs and the releases that you're getting on your schedules, 30 and 45 days out, was the swing really that extreme at sort of 6% global and then the 5% would just focus on what you're looking at? Or when you were looking at your individual runs, was it maybe a little bit less disruptive?

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

Well, that was the problem with this quarter was it's easier to handle and adjust for when it is that kind of onetime event. We also make schedules get adjusted and that never happened. Instead, it was on a weekly basis. So OEMs would have said, "Hey, we're going to take x amount of parts." And by the time the week happened, they were taking 4% to 5% less than they had anticipated taking. And it was just -- it was like that week upon week for really a good portion of the quarter. So unfortunately, we really didn't get any advanced warning of that change. It was more just cumulatively over the entire quarter. And that makes it really hard to plan, makes it obviously not the most efficient manufacturing environment either.

Operator

Our next question comes from the line of David Whiston with Morningstar.

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

Wanted to stay with these order changes for a second. The -- I assume it's primarily cancellations. But is it almost entirely from WLTP or are there other things going on?

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

There were others as well. I mean, really, North America, Japan and Korea, they had the same incident rate. I mean, it really was on a percentage basis pretty similar. It did vary by OEM somewhat. But there was a pretty significant change in production obviously in North America, Japan and Korea markets as well.

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

Okay. And you did keep your 2019 revenue growth percentage rates unchanged, obviously, off of a slightly lower base. But if there's no -- you talked earlier about whether we get this bounce back in Europe, a million-dollar question. If there is no bounce back in Europe, is your 2019 revenue guidance pretty much tells to that point or you think you could still maintain it?

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

Yes, it will probably be just towards the bottom end of the guidance. But obviously, I think the midpoint is what we feel pretty comfortable with, barring any unforeseen changes. And obviously, it would shade towards the bottom end if there is no pushback or push out of some of these additional volumes that were dropped in Q3.

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

Okay. And finally, are there any upstream -- tariffs aside, any upstream supply issues with electronic components that you're trying to get, that you're having a hard time getting?

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

Yes, the entire industry is going through a bit of a tough spell when it comes to passive components. Demand's higher than capacity right now in a lot of places that's driving some cost increases for a lot of suppliers and lack of availability. We're working hard to try to make sure that doesn't affect our overall margin profile. But it is a tremendous amount of work we've been going through really for the last 6 months, and we know it's not going to end anytime soon. So it's something that we keep paying attention to and working really hard on to try to make sure that we have the right suppliers and the right arrangement set up with each of them to make sure we can get the components we need at a price that's fair.

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

And are those suppliers asking you for more money right now to make that happen?

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

Yes, some of them are, yes. There's -- some of the passives are overbought, and that's obviously drive -- driven them to go to the market looking for some price increases.

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

And is it fair to say as long as you say you can still be -- have -- at a reasonable price, you'd be willing to pay a slight increase?

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

That depends. I probably wouldn't say that publicly ever on anything. But if you look at availability and the right supplier, I mean, obviously, we're trying to negotiate fair deals and have partners and suppliers that we want to work with. So it's obviously in the wheelhouse or in the conversation. It's just making sure that we have a long-term plan with each of those suppliers of how to make sure they're investing in the right infrastructure and give us the trajectory we need not only on availability of components but on the price of those components.

Operator

And our next question comes from the line of David Stratton with Great Lakes Review.

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

Really quick since most of this stuff has been answered already. I just wanted to touch on your dimmable windows that you've highlighted in your concept vehicle and then you also referenced in the Autonomous Vehicle magazine recently. And just -- if you're getting any traction there, is this -- any detail you can give around what you're seeing, what you're hearing from customers about the potential application of that would be great.

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

This is Neil. I think the general aspect -- I'll cover at a very high level. There is a great market interest for dimmable devices. From a -- take a sunroof as an example, there are use cases out there that exist that people are looking to change how the vehicle is styled and how they -- the aesthetics of it. And when you look forward to autonomous, they're looking for ways to changing the environment. So there is interest. There's a lot of discussion. There's a lot of development that still needs to occur. I think we even talked about it earlier this year at CES that it's a 5-year process to get this technology to a state where it can be put into the automotive environment and actually be durable and reliable to last the life of the vehicle. So we're working really hard on it. But we've got time. There's a 3-, 4-year period here where we're still going to be in the development stage to make it successful.

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

Just a quick jump onto that. If you look at this week, we were at the NBAA show. So the business jet, aerospace show in Orlando. The team was down exhibiting and showing those customers kind of the -- some of the changes that we've made to that product on the aerospace side. And we believe there's tremendous amount of opportunity longer-term in aerospace, not only in business jets, but also in commercial airline. A lot of that business development effort is focused on that industry right now because we know how to -- I mean, a successful program in the Boeing 787 that we're trying to leverage off of to help drive growth in the aerospace group. Then additionally, at CES, I mean, in our closing comments, we mentioned at CES, we welcome everyone to come to the booth. We're hoping to show some improvements in iteration and the design of those products beyond just the IPD that you saw at CES and hopefully moving into some more tactical executions and showing that it's beyond just a proof-of-concept that we're starting to make progress on the manufacturability.

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

Great. And then really quick, back to the automotive application. Would you say that the interest that you are seeing is more from, like you said, the sunroof aspect? Or more from autonomous vehicle manufacturers who have that in the pipeline?

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

Well, what's exciting is we believe this technology is relevant in the car today, not just the car of the future. And that's why the investment and that's why the work that we are doing as a team to try to make sure we can show what we believe are large-area devices can represent not only today but in the car of the future.

Operator

Our next question comes from the line of Glenn Chin with Buckingham Research.

Glenn Edward Chin ***The Buckingham Research Group Incorporated - Associate***

So just a quick question. I apologize if I missed it. But just a quick question on gross margins. So the gross margins, they contracted 140 basis points year-over-year. But even ex the tariff impact, you are still down 80 basis points. Can you guys quantify the various factors that caused the compression? It's somewhat counter to what one would expect given your shipment growth in the quarter.

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

Thanks, Glenn. The biggest driver, as we always talk about, is annual customer price reductions on a year-over-year basis, that if we can offset those through our purchasing cost reductions, which we've had some constraint earlier in the year, and then if you look at our sales growth rate, that's the other great piece, right? On first half of the year and even in the third quarter, we're at low single-digit growth rates. And in order for us to leverage that, we need between 5% and 10% growth rate to help leverage the investments we're making in automation and capacity expansion. And so those are the primary factors. But as we get into the back half of the year, like Steve mentioned earlier, we are getting more benefit from our purchasing cost reductions. The margins have actually expanded if you go from -- ex tariffs from the first half and then through the third quarter. And if you back off kind of the impact of tariffs, what the fourth quarter looks like, you would imply that the tariff -- margins are going to improve from there sequentially as well. So we're pretty excited about the fact that the margins have actually moved up throughout the year in this tough environment.

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

Well, I would add one other factor in light of the mix changes. So as we talk about the China market and our growth into the China market, those are primarily with base auto-dimming mirrors that are below corporate average. And so there's been a tremendous amount of growth in our core base auto-dimming technology, and that growth rates are a headwind to overall corporate gross margin. But they are indicative of the fact that our products are interesting, relevant and wanted by our customers.

Glenn Edward Chin ***The Buckingham Research Group Incorporated - Associate***

Yes. Okay, so that's still a factor, Steve?

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

Yes, exactly. As we're...

Glenn Edward Chin ***The Buckingham Research Group Incorporated - Associate***

(inaudible) that?

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

Yes, exactly. Our base auto-dimming mirrors have been growing pretty quickly, and that is a negative mix for us.

Glenn Edward Chin ***The Buckingham Research Group Incorporated - Associate***

Okay. And so Josh, you mentioned the annual price downs. Can you tell us what those are running at? And is that any different from what they've been historically?

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

No, they're running at a 2% to 3% range, probably in the midpoint of that, pretty stable. I think a couple of years back, we were in the low end. But this year, it's really been right in the midpoint of that range. And a lot of that is due to forward contracts. I mean, some of that is due to -- we're willing to give a little bit more to some customers if they -- if we have contracts tied to new business in the future.

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

So a lot of that -- a lot of those are, like Kevin mentioned, a lot of those are indicative of the success we're having with products like new technologies like Full Display Mirror. And so those commitments from OEMs typically come with a response from us that means we're negotiating slightly larger price decreases on current products in exchange for that future business. And that's pretty common business practice for the company.

Glenn Edward Chin ***The Buckingham Research Group Incorporated - Associate***

Okay, very good. Sorry, Kevin, I thought that was Josh. What about raw materials, any impact from raw materials?

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

Yes. There was some this year as well. Like the -- like we are talking about in the, I think, with the previous call, some of the passive components and some of the electronics that moved down quite as much of this year as they have in the past. And so that caused, from the beginning of the year, kind of the beginning part of that margin squeeze, both the product mix on the sale side and the cost side from our suppliers caused that step down to beginning of the year. What we have done is improve each quarter from the beginning of the year.

Operator

Thank you. And I'm showing no further questions at this time. I would now like to turn the call back to Mr. Josh O'Berski for any closing remarks.

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

Great. Thank you, everyone, for your time today. As Steve mentioned, we're happy to host investors at CES and SEMA, and we've already been setting up meetings at those shows with our analysts. So feel free to join on one of those groups or contact me directly in the coming weeks as we get close to those shows. As always, thank you, and have a great weekend.

Operator

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