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GNTX.OQ - Q1 2021 Gentex Corp Earnings Call

EVENT DATE/TIME: APRIL 23, 2021 / 1:30PM GMT

**OVERVIEW:**

Co. reported 1Q21 net sales of $483.7m, net income of $113.5m and diluted EPS of $0.46. Expects 2021 revenue to be $1.94-2.02b.

## CORPORATE PARTICIPANTS

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

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

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## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the Gentex Report First Quarter 2021 Financial Results Conference Call. (Operator Instructions)

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

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

Thank you. Good morning, and welcome to the Gentex Corporation first quarter 2021 earnings release conference call. I'm Josh O'Berski, Gentex Director of Investor Relations, and I'm joined by Steve Downing, President and CEO; Neil Boehm, Vice President of Engineering and CTO; and Kevin Nash, Vice President of Finance and CFO. This call is live on the Internet and can be reached by going to the Gentex website at www.gentex.com. All contents of this conference call are the property of Gentex Corporation and may not be copied, published, reproduced, rebroadcast, retransmitted, transcribed or otherwise redistributed. Gentex Corporation will hold responsible and liable any party for any damages incurred by Gentex Corporation with respect to any unauthorized use of the contents of this conference call.

This conference call contains forward-looking information within the meaning of the Gentex safe harbor statement included in the Gentex reports first quarter 2021 financial results press release from earlier this morning and, as always, shown on Gentex website. Your participation in this conference call implies consent to these terms.

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

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

Thanks, Josh. For the first quarter of 2021, the company reported net sales of $483.7 million, which was an increase of 7%, compared to net sales of $453.8 million in the first quarter of 2020. During the first quarter of 2021, vehicle production levels were negatively impacted by electronics and other part shortage issues. These shortages were the primary reason for the 12% reduction in North American light vehicle production compared to the beginning of the quarter forecast. The part shortages also impacted light vehicle production levels in Europe and the Japan and Korea markets, which were each down 3% versus the beginning of the quarter forecast. The part shortages and corresponding change to light vehicle production are estimated to have reduced our revenue in the first quarter by approximately $45 million.

Despite these issues, the first quarter of 2021 was the second highest sales quarter in company history, behind only the fourth quarter of 2020. Our guidance for the year included a first quarter that was forecasted to be similar to the fourth quarter of 2020 from a revenue perspective, but first quarter revenues were clearly impacted by the difficulties created by part shortages.

During the first quarter of 2021, our primary revenue-generating markets of North America, Europe and Japan and Korea were down 2% on a combined basis, which means our revenue growth of 7% yielded a total outgrowth versus the underlying market of 9%. It is also important to remember that the first quarter of 2020 was negatively impacted by COVID-19 shutdowns, which means the vehicle production levels for the first quarter of 2021 were down 15% in comparison to the first quarter of 2019. However, our revenues grew by 3% when comparing those quarters, which calculates to an 18% outperformance versus the underlying market during that 2-year period.

For the first quarter of 2021, the gross margin was 37.9% compared to a gross margin of 34.5% for the first quarter of 2020. The gross margin improved significantly on a quarter-over-quarter basis, which was driven by the structural cost savings put in place in the second quarter of 2020 as well as product mix tailwinds related to exterior auto-dimming mirror growth and full display mirror growth. Gross margins were negatively impacted during the quarter as a result of the part shortages that caused raw material price increases and increased freight costs.

The company has once again performed very well in an incredibly difficult operating environment. The chaos created this quarter by component shortages, freight issues as well as customer plant shutdowns and order changes made scheduling very difficult. But the team was able to not only keep up with customers' orders but also improved gross margins by 340 basis points versus the first quarter of last year. While the gross margin in the first quarter of 2021 was below our annual guidance range, the majority of that shortfall was driven by the $45 million in lost sales in the quarter. We expect to see further improvement in gross margins based on the higher sales levels that are forecasted for the remainder of the year.

Operating expenses during the first quarter of 2021 decreased by 4% to $49.6 million compared to operating expenses of $51.6 million in the first quarter of 2020. The decrease was primarily driven by the continuation of the structural cost reductions made during the second quarter of 2020, but the lack of international travel and the cancellation of all industry-based trade shows because of the pandemic also contributed to lower operating expenses.

Income from operations for the first quarter of 2021 was $133.7 million, which was an increase of 27% when compared to income from operations of $105 million for the first quarter of 2020.

During the first quarter of 2021, the company's effective tax rate was 16.1%, down from 16.6% during the first quarter of 2020. The decrease in the tax rate was driven by increased foreign-derived intangible income deductions as well as increased discrete benefits from stock-based compensation.

Net income increased 27% to $113.5 million for the first quarter of 2021 compared to net income of $89.5 million in the first quarter of 2020. The increase in net income was driven by the quarter-over-quarter increase in sales, improved product mix, higher gross margins and the continued operating leverage as a result of the structural cost savings that were put in place during the second quarter of 2020.

Earnings per diluted share for the first quarter of 2021 were $0.46, an increase of 28% compared to earnings per diluted share of $0.36 for the first quarter of 2020. The increase in earnings per share is a result of the higher net income and a lower diluted share count when compared to the first quarter of 2020.

During the first quarter of 2021, the company repurchased 2.8 million shares of its common stock at an average price of $35.46 per share. As of March 31, 2021, the company has approximately 6.7 million shares remaining available for repurchase pursuant to its 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 will take into account macroeconomic issues, including the impact of the COVID-19 pandemic, market trends and other factors that the company deems appropriate.

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

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

Thanks, Steve. Automotive net sales in the first quarter of '21 were $475.6 million compared with $439.9 million in the first quarter of '20, which was an 8% increase quarter-over-quarter. Auto-dimming mirror unit shipment growth outpaced revenue growth during the first quarter of 2021, primarily as a result of the 15% growth in international shipments. The increase in international unit shipments were largely comprised of base interior and exterior auto-dimming mirror unit shipments and included significant growth in the China market. Other net sales in the first quarter of '21, which includes dimmable aircraft windows and fire protection products, were $8.1 million, a decrease of 42%, compared to other net sales of $13.9 million in the first quarter of '20. Dimmable aircraft window sales decreased by 70% for the first quarter of '21 when compared to the first quarter of '20. The company continues to expect that dimmable aircraft window sales will be impacted until there is a more meaningful recovery of the aerospace industry and the Boeing 787 aircraft production levels improve.

In terms of the balance sheet, during the first quarter, the company continued with its capital allocation policy and maintain high levels of liquidity so that we remain flexible and well positioned to handle these ongoing uncertainties in the industry.

I'll now highlight some key balance sheet items as of March 31 as compared to December 31 of '20. Cash and cash equivalents increased to $455.9 million, up from $423.4 million, primarily due to cash flow from operations, which were partially offset by share repurchases, dividend payments and CapEx. Short-term investments were $25.9 million, down from $27.2 million. Long-term investments were $172.9 million, up from $162 million. Accounts receivable decreased to $277.7 million from $284.9 million. Inventories were $233.1 million, up from $226.3 million. Accounts payable increased to $107.1 million, up from $84.8 million, primarily due to month end payment timing. Accrued liabilities were $116.2 million, up from $92.9 million. Increases were due to higher accrued salaries and wages as well as accrued income taxes.

For the first quarter, cash flow from operations was $190.8 million, up from $151.3 million in the first quarter of '20. The increase in cash flow was driven by increases in net income for the quarter and changes in working capital.

CapEx for the first quarter was $12.6 million compared with $15.6 million for the first quarter of 2020. And depreciation and amortization for the first quarter was $25.6 million compared with $26.3 million in the first quarter of '20.

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

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

Thank you, Kevin. In the first quarter of 2021, there were 10 net new nameplate launches of our interior auto-dimming mirrors and electronic features, net of previously disclosed feature headwinds. Despite the challenges our industry has been facing, the net launch rate for inside auto-dimming mirrors and advanced features was strong and one of the highest first quarter launch rates in the last 3 years.

During the quarter, there was a good mix of both auto-dimming -- both base auto-dimming and advanced feature mirrors. The inside auto-dimming mirror launches included new models in all of our major markets, and the advanced feature launches were led by new models of HomeLink.

Now for an update on Full Display Mirror. Since our last announcement of Full Display Mirror launches, we have had 6 new nameplates enter the market. Those nameplates are the Buick Envision, Buick Velite 7, Jaguar E-PACE, Toyota Mirai, Toyota Sienna and the Ram 2500, 3500.

Here's a comprehensive list of the OEMs and the number of nameplates where we are currently shipping FDM. General Motors, our initial launch customer, has 24 nameplate shipping. Subaru is currently shipping on 3 nameplates. At Nissan, we're shipping on 2 nameplates. Toyota is now shipping on 12 nameplates. Jaguar Land Rover, we're currently shipping on 6 nameplates. Aston Martin, 1 nameplate. Mitsubishi is shipping on 2 nameplates, and Ram is shipping FDM on 3 nameplates. As we look forward to the second quarter and the balance of the calendar year, we realize that many of our customers' expected launches of new vehicles may be affected by the current market shortages. However, we're optimistic as we continue to see strong demand for our latest products and technologies.

In the last quarterly call, we gave an update on an acquisition we did in 2020 of a company called Vaporsens, a nano fiber sensing company. This acquisition was focused on expanding our sensing capabilities for vehicles today and into the future as well as grow in other market verticals. In late 2020, we completed another acquisition of a company called [Argo]. Argo was a small company in California, working on conductive polymer electrochromic technology. As we've demonstrated at CES for the past few years, one of our technology strategies is to expand the use cases for dimming technology. So with the addition of the Argo team and technology to the Gentex product portfolio, we have a broader path in dimming technology that will allow us to achieve more of the use cases. This technology is still in development and a few years away from production viability, but we're excited about its potential to help us expand the dimming market.

In summary, even with current challenges our industry is facing, our launches and product rollouts are strong. And with the addition of these new sensing and dimming technologies, we believe we're positioning the company to take advantage of the trends that are developing and the interest we have gathered over the last several years at CES.

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

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

Thanks, Neil. The company's current forecast for light vehicle production for 2021 and 2022 is based on the mid-April 2021 IHS Markit forecast for light vehicle production in North America, Europe, Japan, Korea and China. Based on this information, light vehicle production in the company's primary markets is expected to increase approximately 10% over the 2020 calendar year volumes.

It is important to note that from our January earnings call until today, the IHS vehicle production forecast for our primary revenue-producing regions of North America, Europe and Japan and Korea had decreased by about 3%.

For calendar year 2022, light vehicle production in the company's primary markets is forecasted to increase over the 2021 estimated volumes by approximately 7%. Based on these light vehicle production forecast and despite the lower vehicle production volumes that are now forecasted for 2021, we are reaffirming our guidance estimates for calendar year 2021 for each of the following areas: revenue for 2021 is expected to be between $1.94 billion and $2.02 billion; gross margins for the year are expected to be between 39% and 40%; operating expenses are forecasted to be approximately $210 million to $220 million; our estimated annual tax rate, which assumes no changes to the statutory rate, is forecasted to be between 16% and 18%; capital expenditures for 2021 are expected to be between $85 million and $95 million; and depreciation and amortization is forecasted to be between $105 million and $110 million.

Over the last several quarters, the company has been closely monitoring the tariff discussions between the U.S. and the EU. Currently, EU Regulation 2018/0886 is scheduled to go into effect on June 1, 2021. The company remains hopeful that a trade agreement can be reached before this date so that the increased tariffs do not take effect. If these tariffs do go into effect on June 1, the company estimates an impact in 2021 of approximately $7 million to $10 million in incremental expense that is not contemplated in the guidance.

In addition, based on the mid-April 2021 light vehicle production estimates for calendar year 2022, the company is increasing our estimates for calendar year 2022 revenue to be approximately 8% to 13% higher than the estimated revenue for calendar year 2021.

In conclusion, I'd like to reiterate a few key points regarding our performance. Our forecast for calendar year 2021 remains strong despite the supply chain issues that are continuing to impact the current vehicle production environment. While these issues create instability in the short term, the industry dynamics currently point to improved light vehicle production for the second half of 2021 and also the continued recovery of light vehicle production into calendar year 2022.

More specific to Gentex, the combination of our launch cadence, product mix and overall program awards continue to provide us confidence about the future growth rate and health of our business in an otherwise hard-to-predict market.

Over the last 12 months, our employees have been able to adapt to every situation we have encountered. First, it was never seen before shutdowns, followed by the busiest 6 months in company history. We are now battling to make sure we are able to provide products to our customers at the volume and timing they require without compromising our commitment to the quality standards that underlie our reputation in the industry. Accomplishing these objectives has become quite difficult, but we're not satisfied with those accomplishments alone. During this difficult time, we have continued our active pursuit of new technologies, maintained our focus on cost discipline that yielded margin improvement on our core business and continue to invest capital in the company, all while maintaining our rigorous approach to capital allocation and share repurchases.

We trust that the hard work the team has done will help fortify the confidence you have placed in us and that this trust will be rewarded with above-average market returns for years to come.

That completes our prepared comments for today. Thank you for your time, and we can now proceed to questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Your first question comes from the line of James Picariello of KeyBanc Capital.

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

Bridging the first quarter's performance to your reaffirmed full year guide, and I know you utilize IHS as you're base framework for industry production. I mean it looks like second quarter volumes are expected to trend flat sequentially, right, based on IHS. So the $45 million volume impact that was called out this quarter likely sustained. So just wondering how we should be thinking about the trajectory from here, second half volumes better? Does the supply chain inflation, the freight -- does that -- do those headwinds go away? Just -- yes, the bridge to the full year would be great.

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

Yes. On the revenue side, I think you're exactly right. I mean Q2 is going to be pretty similar to Q1 in terms of size. Really the improvement and what we're seeing and hoping for is that the second half strengthens. And that's what IHS is forecasting versus beginning of the year. The second half has gotten better. Really what that's going to be dependent on is the supply chain side. If things -- and right now, it's estimated that the constraints will slow down a little bit in the second half of this year versus what we've seen in the first quarter. So we think Q2 is going to be a lot like Q1. It's going to be a lot of constraints, a lot of freight issues, definitely a tight supply. Hopefully, by the back half of the year, that starts to settle down a little bit and supports the higher production volumes.

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

Okay. Got it. And then the volumes -- the mirror shipment volumes in the first quarter were pretty strong. And the exterior mirrors, especially that's favorable mix, the numbers, the growth rates came in, really nicely there. But it looks like the implied price/mix, right, volume plus price/mix -- the price/mix side was still down year-over-year. Just curious how we should be thinking about price/mix and maybe tying that into FDM shipments for this year. How does that trend?

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

Yes. I mean, really, there was a couple of factors happening there. Number one is the impact of annual price reductions. So you're looking between 2% to 3% on most years that take effect on January 1, which is part of the reason for the year -- the decline. The other part -- what's interesting was if you look, North America and Europe, Japan, Korea were really on a negative trend from a vehicle production standpoint. The China market actually increased significantly, and we saw quite a bit of increase in sales in the China market. Those tend to come at lower ASPs. So they're typically base auto-dimming interior mirrors. So your ASP on that is in the low 20 range. And so that was part of the -- why you'd see ASPs kind of trending down a little bit in the first quarter.

**Operator**

Your next question comes from the line of Luke Junk with Baird.

**Luke L. Junk** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

First question on the FDM. Just wondering if you could comment on how current production headwinds are impacting take rates and so far that we're seeing OEMs prioritizing their more profitable vehicles. Is this helping take rates incrementally? And could there be any longer-term benefits to Gentex?

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

Yes. I think -- well, I don't think -- longer term, I think you'll see over -- and part of the reason you'll see late '21 and '22 as OEMs -- there's no doubt that OEMs are building at the top end of the spectrum right now in terms of content and feature set. But I'll caution that by saying part of the reason you see micro shortages and some of the component shortages is with that advanced -- they're trying to build higher dollar value vehicles. The problem is that's also where you're having the electronic shortage issue. So what we expect is that volumes will increase throughout the next 18 months, but that's also going to come with some lower content and features, some of the vehicles that aren't being billed are on the low end of the take rate side for us.

So what we've seen is that there has been a trend towards higher take rates on a lot of our advanced features, not just FDM. The problem has been, obviously, adds additional pressure on the micro shortage issue. And so we think that, hopefully, by the second half of this year, that starts to slow down -- like the constraints start to slow down a little bit. The issue becomes longer term is how high does the content -- does it stay this level of take rates or does it go back to a more normalized take rate.

I think what we're seeing on FDM -- we're not concerned that take rates are going to drop because of that. It's more about how do we get those same type of take rates on different stratification of vehicles that are billed. Because if we can, then that obviously would signal a great success for us with FDM on multiple vehicles.

**Luke L. Junk** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. That's helpful. And then switching gears, I wanted to drill down on some of the specific supply chain dynamics that you're seeing in terms of your own supply chain. And just wondering to the extent that you're [centralized] production model and the amount of inventory that you hold on hand is helping you to mitigate these headwinds, if we could talk about those dynamics a little bit.

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

Yes. I say the dynamic side, it's been crazy. I mean it's not just about the availability of micros, but it's -- and it's all kinds of electronic components. I mean it's as simple as circuit boards all the way to high-end micros. And that's been difficult. Obviously, the industry went through -- pretty much globally, a lot of suppliers went through a few month period of shutdowns due to the pandemic, and then catching up has been very difficult and how fast that market's responded -- our market, in particular, has responded has caused those issues. And so it's been a rolling problem. I mean we basically have a watch list going constantly of supply issues and people that we're watching and communicating with daily to try to make sure that we get what we need to keep our customers producing.

Beyond that, I think what's really fascinating to watch is how does this -- how does the industry ever actually catch up. And right now, we're hoping that through the summer and some of the normal shutdowns and retooling the OEMs go through, that there's a little bit of a break there to help some of the supply chain catch back up.

The other side has been wild. I mean you look at freight, and a lot of these components are coming from Southeast Asia. So you got all the issues from Suez Canal to all the ships sitting off the West Coast. It's caused a lot of freight issues there. I mean not just in terms of getting the parts, but how much you have to pay an expedited freight to try to get them here on time. And so there's been a lot of headwinds on the cost side related to that.

So we're hopeful that with some of the constraints hopefully ending in the second half, that we can get those freight costs back under control as well.

In terms of our inventory, yes, that absolutely has helped us not shut down an OEM. The problem is, obviously, if you can't replenish that stock, then you end up like everyone else, which is day-to-day needing shipments in order to be able to keep up with production demands.

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**Operator**

Your next question comes from the line of David Kelley with Jefferies.

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

Apologies for the background noise and an airport here. But maybe to follow up on the full year guide, maintaining your outlook despite the headwinds, the disruption and then kind of the IHS numbers coming down a bit. Can you just talk about some of the incremental positives that have emerged over the past 2 to 3 months are helping to kind of offset those incremental headwinds?

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

Yes. Thanks. This is Kevin. I think we've seen a bit of a resurgence in the China market, as Steve alluded to earlier. Really good growth in some of the base level products, and that volume has been applied throughout the year. And we've seen great strength in take rates in that market as well as the North American market and some of the things that Neil talked about is some of the launches are taken off on time and with take rates that we were expecting. And so it's really bolstering that. But again, a lot of that is driven by what IHS is estimating to be easing of that supply chain issues in the back half.

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

I think I can add that some of the strength, too, has been on Full Display. I mean Full Display Mirror continues that growth rate that we were on really for the last couple of years. So that's been strong, and the ITM launches have been going very well, too. So that's been helping to add some positive revenue.

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

Okay. And then maybe a quick follow-up, Kevin, to your point on China. Can you give us a sense of kind of where the auto-dimming penetration is today and what that penetration has done over the past couple of years or so?

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

Yes. So I'd say it's grown drastically in the last couple of years. I'm going to go all back of the envelope real quick on that. I think it's probably around 15% to 20% -- probably about 15% of the China market right now has -- is the base auto-dimming inside penetration rate in that market.

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

Okay. Got it. And then last one for me, and I'll pass it along. Just curious -- I mean it sounds like the visibility to the back half of the year is pretty strong here, assuming that the supply chain improves, but how should we think about kind of the normalized gross margins in the back half, and again, removing kind of supply chain impact that helps you get to that full year 39% to 40%? We're just kind of trying to bridge the gap here to what appears to be kind of second quarter gross margins. It'll probably be somewhere in the first quarter range to that second half uptick that gets to 39% to 40%, that'd be great.

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

Yes. I would say, like you mentioned, we're expecting the second half to, a, be a little higher than the first half in terms of total sales dollars. So the contribution margin of those incremental sales are what's going to help us drive to the midpoint or slightly above the annual guidance range in the second half of the year. And that's how we get to that still inside of that annual guidance range for full year.

Some of the factors that we historically have seen, and not only the higher revenue that should help us in the second half, but as Kevin always mentions in these calls, we talk about the first quarter and usually the second are both impacted negatively by the fact that we're still carrying inventory from prior year at that year's cost basis. And then as we start to move through March, April, May, we start to see the positive impacts of purchasing cost reductions of the raw materials. And so that usually helps the second half as well. And then obviously, as we talk about the growth rate, the growth rate can get above the 5% to 10% range. Usually, you see obviously positive flow through to the income statement with that higher growth rate.

**Operator**

Your next question comes from the line of Josh Nichols with B. Riley.

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

Good to see the company reaffirming the 2021 outlook. If you could provide a little bit more color -- I mean nice to see the '22 outlook actually get raised here. What's really the areas of strength that give you enough confidence to raise despite some of the near-term shortages we're seeing? Is it Full Display Mirrors, ITM? And what are the puts and takes for that '22 outlook?

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

Yes. I think -- well, the -- I mean, first, what we mentioned, I think in first -- at the year-end conference call in January, one of the things we did talk about is we were a little bit bearish on IHS vehicle production forecast. That turned out to be probably well-founded concern. Obviously, watching that drop by 3% in the quarter for the full year was something that we had to keep our eye on. And we're probably a hair bearish on the IHS number in terms of total growth. But what gives us the confidence is actual take rates of our products, the launches that Neil was discussing, continued strength and interest in our Full Display Mirror, ITM, some of the new technologies that we're rolling out. So even absent -- not hitting the exact number on IHS total vehicle production growth rates, we feel like that our content is doing quite well in the market. And that's really -- those are really the key drivers of why we feel like we could raise that guidance for 2022.

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

Yes. And then just for a little bit of clarity, looking at the back half of this year, how much of the supply change shortage is expected to kind of alleviate? Is it expected to still be some lingering impact or -- in the second half? Or what are the thoughts regarding the second half forecast?

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

Yes. I mean it's funny, when -- everyone you talk to will have a different opinion on that. If you look at -- my personal belief on that is that it's going to last longer even in the second half of this year. If you look at how long it takes capacity to get put in place for these type of components, it's not going to happen in the short term. And so you're talking 18, 24 months at least before you could see any type of capital investment in the supply chain kind of improve total capacity.

Really, what you're going to be looking at is trying to catch up from those -- downtime that happened due to the pandemic is step number one, and that's starting to happen, but it's going to take several more months before they can even get there. And then there's -- obviously, you're talking about shared resources with consumer electronics. And so the question there is, will consumer electronics trend up or down over that same time period? And what about automotive content? And so I personally think it's going to be more like an 18-month play before you start to see total relief, but we do think it'll get a little better than what it's been in Q1. I mean Q1 was with pretty harsh environment from the supply side. And so we think that'll lessen but not go away by the second half of the year.

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**Operator**

Your next question comes from the line of John Murphy with Bank of America.

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

You get to a lot of my questions, but I have just a couple left. On the raw material costs, I'm just curious if you think that's a headwind that may ease as we go through this year and into next year. Or is that something that remains?

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

I think raw material actually is probably going to get worse throughout the second half of the year. And the reason why is a lot of the electronic suppliers are coming with price increases to customers. So that -- very little of that actually hit in the first quarter. There was a little bit of it, but there'll be more in the second quarter and beyond. But we believe that the freight issues will start to drop in the second half. And so we think those -- the headwinds we experienced in Q1 will be very similar to what we see in Q2 through Q4. It's just going to be a different mix, right? It'll be more raw material headwinds, but less on the freight side.

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

Got it. And then on the semis, I mean, you just gave some color on this. But if we think about next year and everybody maybe out of their homes and not find as many computers and screens and Playstations and the like, do you think that there's the potential that this could swing back in the other direction where capacity frees up, then autos becomes the best game in town for the semi companies, and you have this ease dramatically and maybe actually become a tailwind for you at some point next year?

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

Yes. I don't know if it'll be next year, but I think in a 2 to 3-year window, that's possible. I think there's a lot of semis that are putting additional capacity in place and spending a lot on capital right now. So if you look at -- maybe there's a 10% or 15% increase in overall production capacity, and I think that's where we'll get that relief and start to see this be more like you described it. Historically, you looked at high-end electronics in a 3% to 5% down market a year on ASPs. We would expect that to happen again, but we think it's going to be a few years before that begins to become the normal again.

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

Okay. And then just lastly on China. I'm just curious, what percent of your sales are going -- or being delivered to China? Who are the customers? And it sounds like it's mostly base interior and exterior mirrors for now, but what's the typical curve for that to become more advanced mirrors over time?

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

Yes. Right around -- in the quarter, it was right around 7%, 7.5% of total revenue were shipments to China. But most of our revenue is through joint venture OEMs. We also have exposure to the Tesla plants in China, which is obviously taking off. And so it's a pretty broad spectrum. But we do have launches, as Neil has mentioned, in the past several quarters with some local Chinese OEMs. And it's just -- it's really the play as far as expanding the ability to do things locally. The tariffs still remain a headwind going into China and thinking about how we manage the supply chain there for future growth with advanced features. The product, everybody loves it. It's just a matter of considering some of those things.

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

One -- and your other question was how do you -- what does that development curve look like? We believe that after several years in the market -- with the growth that we're getting right now on base auto-dimming technology, we believe that will open the door to more advanced features. We have done some in China. But longer term, we need to work towards market-specific features that are unique to the China market, and that's what we've done historically really well. I mean Full Display Mirror is obviously a great opportunity because it defies borders and regions, but there are some market-specific type technologies that we need to continue to work on to help that advanced feature content in the China market.

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

And I think I know the answer to this, but I'll ask it anyway. I mean is there any thought of building a production facility over there? Is everything going to stay in Zealand?

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

Right. I mean what we have -- we've actually -- we bought a new building a couple of years ago in China. We have a distribution center there. We actually bought a new building a couple of years ago that we're just getting occupancy in right now. We did a renovation of that building. What that building offers us up is a lot more storage for inventory for finished goods out of Zealand into the China market. It also opens up the door for us to be able to do [like] final assembly there to support customer demands and to help with the tariff situation. So we have plans in place right now to continue to look and expand our ability to do local final assembly in that market.

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

And that final assembly skates or DUCs below potential tariffs, is that...

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

Well, what it does is it takes -- yes, it takes a lot of that dollar content, say, plastics and metal mounts and even circuit boards and says we're going to find a local supplier for those. So those would then avoid -- you wouldn't have duty on stuff that you source domestically in Asia. But the core auto-dimming elements are something that we would still produce in Zealand and ship there, but it lowers the total amount of tariff because the dollar content drops.

**Operator**

Our next question comes from the line of Ryan Brinkman with JPMorgan.

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

You've discussed in the release about the part shortages that resulted in raw material price increases. Can you talk about what your biggest raw material buys are and which are the ones that are contributing to the increase? Is it primarily the electronics components you've been talking about? Or is it more based materials? I'm not sure to the extent to which you might be exposed to like polypropylene or thermoplastics, maybe used in housing. We're seeing a lot of increase there. And then also, could you talk about any kind of customer pass-throughs that you might have in place?

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

Yes. So the largest purchase that the company undertakes is obviously micros electronics -- the components. The biggest negative impact, however, this quarter we saw was in some precious metal markets. What we see -- what we saw in the quarter. But going forward, it's really the price increases that Steve alluded to really starting to take hold in the back half of the year on the electronics side. But we do have exposure to the plastics issues that are also impacting the market and price increases potentially in that realm as well.

What was the last part of the...

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

The customer pass-throughs.

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

The customer pass-throughs. I mean with our products being market-based pricing, we work as hard as we can to push on the APR side, but we take that risk every day when you look at our margin buildup already and try to push on APR either through volume or those type of things. But for the most part, that's for us to figure out on either getting more efficient in the manufacturing process and minimizing the impact of these cost increases.

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

Great. And just lastly, is there an update that you could provide on the Integrated Toll Module product? You've been announcing a lot of awards there with Audi, but I think there's been some expectation you might snag some new ones with other automakers perhaps this year. I'm curious what discussions with automakers look like on that product. And I'm not sure you've disclosed ASP or profitability metrics for that product, but any color you might want to provide there would be helpful also.

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

Sure. I can -- I'll talk a little bit about the product side. So the Audi rollout continues to go extremely well. The volumes have continued to increase over the last year. It's now consumer awareness and getting some of the functionality in place that the consumer is looking for as we continue to improve the product. Second, customer that we've talked about, we expect something in the last part of Q2, early Q3 for that.

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

On the ASP side, ASP is around $50 to $60 for that product.

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**Operator**

Your next question comes from the line of David Whiston of Morningstar.

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

I know in the past, you've talked about how your rock-solid cash-rich balance sheet tends to give you higher priority on [scarce] raw materials when there's supply problems. Is that happening this time around?

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

Yes, it definitely helped us, there's no doubt. I mean there were -- whenever you're going through something like this, one of the things you wake up with sweat every night, it's -- afraid that something happens and you shut down an OEM. I mean that can happen. And we've been fortunate not to have that happen. And our inventory definitely allowed us to fight through that better than some. You can read it pretty much every day. You pull up automotive publications, and you see a different OEM going down because of a shortage by a supply base. And so we've been fortunate, knock on wood, that we haven't been the cause of any of those.

But like we mentioned, as you're struggling to get shipments, you're burning through some of that inventory on hand. And so we're trying to get creative here to make sure we're working with our suppliers to give them plenty of visibility and lead time and make sure we're committing what they need, to make sure we get access to those parts as quickly as possible. But there's no doubt that it helped. The team has done a remarkable job of triaging the supply side to make sure that we have what we need when we need it to get those shipments out on time. Unfortunately, one of the things that did drive is obviously a higher freight cost trend, especially on the incoming side, making sure that we get stuff from the port to us as quickly as possible.

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

And somewhat related then the -- I believe the annual price reduction mitigation that you go through throughout the calendar year, I think Q1 is normally the worst of it because you haven't started the process or only early in that process. But this year, you've got much higher raw material prices, too. So how does that price reduction mitigation effort look this year? Is it going to be extra hard?

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

Yes. It's going to be much more challenging, there's no doubt. I mean if you look at it from a timing standpoint, the basic timing won't change. I think what you're going to see is the amplitude of improvement from Q1 through the back half won't be quite as much as what we've had historically on a normal year because you're going to -- like you said, you're going to burn through prior year inventory in the first quarter. And then as you move through second quarter and beyond, you start to get the positive impacts of the APRs from our suppliers. The issue this year with some material increases in some areas, you're going to see a little bit -- you're going to see not quite the same level of improvement on the purchasing side. And so we're -- what we're modeling is not quite as much benefit there. But like we mentioned before, you're going to see some pickup on freight as the year progresses because we're not expecting the same levels of premium freight charges in the back half is what we've been paying so far.

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

And that actually leads to my last question on -- you had talked earlier on the call about how you've had the offset with lower freight versus the higher electronics prices. So how much of an offset is that lower freight? Is it 30%, 50%, 90%?

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

Well, let's put it this way. Right now, what we saw in Q1 is about 100 to 150 basis points in headwind from raw material and freight combined. And so we don't think that, that number changes drastically in the back half, but we think there is the opportunity for that to obviously go down. But we think there's going to be the majority of those -- that headwind is going to last throughout the year.

**Operator**

(Operator Instructions) Your next question comes from the line of Charlie Sloan of Oak Family Advisors.

**Charles Melcher Sloan** - *Oak Family Advisors, LLC - President & Co-CIO*

Just calling -- just a couple of questions. In the previous cycles, you've seen more lags as the automakers ramp back up versus your production just because you use through inventory, but it doesn't seem like that's going to be the case here because you're just struggling to keep up.

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

Yes. Exactly. Timing is always interesting. If you look at like the downturns even when -- into Q1, Q2 with the pandemic, as OEMs went down, we were continuing to ship. And so there is -- typically, we're anywhere from 4 to 12 weeks ahead of a customer in terms of when we're producing. And so -- but because there's so much constraint and there's less inventory at the OEMs right now and less in route and in transit, we think you're exactly right, there's going to be a little less of that lag than what we would normally see. Quite frankly, we'd love for it to get back because it is a little hand-to-mouth right now. And so I think for the next 6 to 12 months, you're going to see it be much more correlated on a timing standpoint than what it has been in the past.

**Charles Melcher Sloan** - *Oak Family Advisors, LLC - President & Co-CIO*

Okay. And then on the FDM, which is if you go back a year to your optimism about FDMs, has anything changed? Or is it more optimistic or less optimistic? How do you perceive it from a year ago? And then my next question would be as a follow-up. Are you giving guidance as to the total shipments of FDMs this year and next?

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

So I would -- I'll start with the optimism. I would say that from a year ago until today, I'd say it's about the same. I mean we felt really good about where the growth rate was and what it was going. Now what I would say is it's been a roller coaster between a year ago to today. Given everything that's happened, you kind of go through, man, is this product going to continue to grow despite the issues that are happening in the industry. And so we sit here today having watched Q1 develop at about the same growth rate we were expecting. And so despite the issues and the problems and everything that's gone on, we're right on track with our growth rate.

What we kind of talked about, to the second part of your question there, is on the growth rate, we're really talking about adding a couple of hundred thousand units a year for -- each year for the next couple of years. And we're right on pace with that. Last year was a huge growth year for FDM, but we continue to expect that thing to increase by 200,000, 250,000 units a year.

**Charles Melcher Sloan** - *Oak Family Advisors, LLC - President & Co-CIO*

Okay. And then finally, given that you guys have managed through the cycle so powerfully, and you have some cash on the balance sheet, about $640 million, right, between cash and long-term investments. Is that right?

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

Yes, sir.

**Charles Melcher Sloan** - *Oak Family Advisors, LLC - President & Co-CIO*

Okay. And so the 5 25 target, have we -- what are we going to do about that?

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

Well, what we've done is we've increased it a little bit through the cycle because quite -- beginning with the pandemic, we started getting a little more focused on cash retention for 2 reasons. Number one is not knowing the long-term economic impact of everything that's been happening. I want to make sure you're prepared for anything that could go wrong on the business side. But number two, and the one that's honestly been a little surprising, we thought through this that there had been more acquisition targets become available at reasonable pricing. Quite frankly, the multiples have not really changed that much in terms of available businesses. And so we are preparing for, hopefully, what we're expecting to be a downturn and a depression of market values of available assets, which hasn't happened. So we're trying to not only prepare for the rainy day but also prepare for the potential for buying if market prices dropped.

**Charles Melcher Sloan** - *Oak Family Advisors, LLC - President & Co-CIO*

Okay. So I'd say we because we are shareholders. We're not just the sell side. We're the buy side. And so if there is any excess capital that you have sitting on the balance sheet, I'm sure shareholders would appreciate that.

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

Yes. That's -- no. And we appreciate it, and we love the confidence that you've shown in us in a long time. And I think one thing we are absolutely adamant about is our goal is not to stockpile cash beyond what's necessary. And that's why that share repurchase plan is kind of our fallback position, saying, hey, we're confident in our long-term growth and what that future will look like over a 5- to 10-year period. And so whenever we have an opportunity, we're going to be buying stock. And whenever we see market retrench too much, we'll get more aggressive on that side as well.

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**Charles Melcher Sloan** - *Oak Family Advisors, LLC - President & Co-CIO*

Okay. Because it does look like -- and you described it, you're describing a wonderful 2021 where your new feature sets are coming into play with higher ASPs. You have a slowdown in some of the freight cost stuff that you run into and probably a pickup in production at the car companies. I look at this and say, wow. Okay.

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

Yes. Neil's team has done a remarkable job on the technologies piece of delivering new features, new content. We believe that sets us up for long-term growth.

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**Operator**

There are no further questions at this time. I would like to turn the call back to Josh O'Berski for any additional or closing remarks.

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

This concludes the Q&A portion of our call. Thank you, everyone, for the great questions. And I hope you have a great rest of your week and a good weekend.

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**Operator**

Thank you for participating in today's conference call. You may now disconnect your lines at this time.

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