REFINITIV STREETEVENTS

EDITED TRANSCRIPT

GNTX.OQ - Q1 2023 Gentex Corp Earnings Call

EVENT DATE/TIME: APRIL 28, 2023 / 1:30PM GMT

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

James Albert Picariello *BNP Paribas Exane, Research Division - Research Analyst*

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

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

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

Ronald John Jewsikow *Guggenheim Securities, LLC, Research Division - Associate*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Gentex Reports First Quarter 2023 Results Conference Call. (Operator Instruction]. Please be advised that today's conference is being recorded.

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

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

Thank you. Good morning, and welcome to the Gentex Corporation First Quarter 2023 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; Neil Boehm, 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 and at ir.gentex.com. All contents of this conference call are the property of Gentex Corporation and may not be copied, published, reproduced, rebroadcast, retransmitted, transcript 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 2023 financial results press release from earlier this morning and as always, shown on the Gentex website. Your participation in this conference call implies consent to these terms. Now, I'll turn the call over to Steve Downing, who will get us started today.

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

Thank you, Josh. For the first quarter of 2023, the company reported net sales of $550.8 million compared to net sales of $468.3 million in the first quarter of 2022, which was an 18% quarter-over-quarter increase and a new quarterly sales record for the company. For the first quarter of 2023, global light vehicle production in North America, Europe, Japan, Korea and China, increased approximately 6% when compared to the first quarter of 2022.

Many of the supply chain issues that held back the industry during last year have improved and the demand for our products, combined with the increased light vehicle production led to record revenue in the quarter. While light vehicle production is still below pre-pandemic levels, Demand for the company's products resulted in a 12% outperformance versus the underlying market.

For the first quarter of 2023, the gross margin was 31.7% and compared to a gross margin of 34.3% for the first quarter of last year. The gross margin was impacted by raw material cost increases and labor cost increases which were partially offset by improvements in freight-related costs and price increases to customers.

As compared to the fourth quarter last year, the gross margin increased sequentially from 31.2% and as a result of the higher sales levels, improvements in freight-related costs, favorable product mix and price increases to customers that carried forward into this year. These tailwinds more than offset the potential margin decline coming from the onetime benefit of cost recoveries in the fourth quarter and the higher labor costs that became necessary last year.

Calendar year 2022 was marred with significant gross margin impacts from raw material cost increases, supply chain stresses, labor cost increases, volatility and overall inflation that resulted in significant downward pressure on our margins and profitability. In the fourth quarter of last year, we began the process of stabilizing and improving gross margins by realizing onetime cost recoveries for calendar year 2022 and securing sustained price increases that carried into the first quarter of this year.

Gross margins hit a low point in 2022 during the third quarter when they fell to 29.8%. But in the fourth quarter, we secured onetime cost recoveries that improved margins to 31.2%. In the first quarter of 2023, we further improved gross margins to 31.7%, even without the benefit of any onetime cost recoveries. Our plan for margin recovery is based on a time line that covers 2023 and 2024 and is designed to achieve a targeted margin profile of 35% to 36% by the end of 2024.

Based on our progress in the last 2 quarters, I believe we are well on our way to accomplishing this plan. Operating expenses during the first quarter of 2023 increased by 8% to $61.5 million compared to operating expenses of $57.1 million in the first quarter of 2022. Operating expenses increased during the first quarter of 2023, primarily due to staffing and professional fees which were partially offset by lower outbound freight expenses.

Our operating expenses for the first quarter of 2023 are slightly below our forecasted range for the full year, but we plan for those expenses to ramp up throughout 2023, and in support of our product development strategy, new business awards, VA/VE initiatives and our expected growth rate for this year and next year.

Income from operations for the first quarter of 2023 was $113.3 million compared to income from operations of $103.3 million for the first quarter of last year. During the first quarter of 2023, the company had an effective tax rate of 15.9% which was primarily driven by the benefit of the foreign-derived intangible income deduction.

Net income was $97.6 million for the first quarter of 2023 compared to net income of $87.5 million for the first quarter of last year. The increase in net income was primarily the result of the quarter-over-quarter increases in net sales and operating profits.

Earnings per diluted share for the first quarter of 2023 were $0.42 compared to earnings per diluted share of $0.37 for the first quarter of last year.

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

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

Thank you, Steve. Automotive net sales in the first quarter of '23 were $537.4 million, a 17% increase when compared to $458 million in the first quarter of '22. And auto-dimming mirror unit shipments increased 16% during the quarter compared to the first quarter of '22. Other net sales in the first quarter of '23, which includes dimmable aircraft windows and fire protection products, were $13.3 million compared to other net sales of $10.3 million in the first quarter of '22. Fire Protection sales increased by 10% for the first quarter, and dimmable aircraft window sales increased by 118% for the first quarter of '23, both compared to the first quarter of '22.

Share repurchases. During the first quarter of 2023, the company repurchased 1 million shares of its common stock at an average price of $27.19 per share. As of March 31, '23, the company has approximately 19.7 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, market trends and other factors the company deems appropriate.

Shifting over to the balance sheet. The balance sheet comparisons mentioned today are as of March 31 of '23 as compared to December 31, '22. Cash and cash equivalents were $215.5 million compared to $214.8 million. Short-term and long-term investments combined were $229.4 million, up from $202.3 million, which includes fixed income investments as well as the company's equity and cost method investments.

Accounts receivable was $332.9 million, up from $276.5 million due to the higher level of sales during the first quarter. Inventories were $401.8 million, down slightly from $404.4 million, and accounts payable increased to $166.9 million, up from $151.7 million.

Looking at preliminary cash flow items for the quarter. First quarter 2023 cash flow from operations was $120.9 million, which was an increase from $115.9 million in the first quarter of '22. CapEx for the first quarter was $42.8 million compared with $23.9 million for the first quarter of '23 and depreciation and amortization for the first quarter was $24 million compared with $24.7 million for the first quarter of '22.

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

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

Thank you, Kevin. In the first quarter of 2023, there were 18 net new nameplate launches of our interior and exterior auto-dimming mirrors and electronic features net of previously disclosed feature headwinds. The quarter was very strong in advanced feature launches with over 70% of the net launches being advanced features.

For the advanced features, Full Display Mirror and HomeLink were a significant portion of those launches.

Now for an update on the Full Display Mirror. During the first quarter of 2023, we began shipping Full Display Mirror on 8 additional nameplates. These new vehicle nameplates are Lexus RZ, the Maserati GranTurismo, the Mazda CX-90, the Nissan Roox for the Japan market, the Toyota bZ4X and the new Toyota Crown for the Japan market, the Toyota Crown Kluger and the Toyota Grandia for China and other markets.

The Mazda CX-90 Full Display Mirror is our first FDM shipping to Mazda and it can be found of their website when building a vehicle under the Accessories section. We're excited to be shipping to Mazda, and we believe the product will be successful in its initial introduction so that we can drive greater penetration over the long term.

At the conclusion of the first quarter of 2023, we have now launched Full Display Mirror on 94 nameplates across all regions of the world. This product continues to see strong growth, and it's been extremely well received by our customers and the consumers. As we look at the remainder of 2023, we are targeting at least 10 additional nameplate launches and we expect that our 2023 unit volume to be at least 300,000 units higher than our 2022 volume.

Full Display Mirror has been in production for over 7 years now and in future quarters, we will only be providing nameplate updates, one that had a significant growth or strategic impact. We'll continue to provide updates on our unit shipments and the progress to the annual goal.

During the first quarter of 2023, we've seen great improvement in supply chain constraints that have been driving us to execute a significant number of redesigns. The team at Gentex has done an incredible job working through all of these issues and constraints to avoid OEM interruptions.

I'm excited to get the team fully back and engaged on new products and launches but some of our development team will continue to remain focused on new iterations of products to help us achieve our gross margin initiatives.

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

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

Thanks, Neil. The company's current forecast for light vehicle production for the second quarter of 2023 and full years 2023 and 2024 are based on the mid-April 2023 S&P Global Mobility forecast for light vehicle production in North America, Europe, Japan, Korea and China. Light vehicle production in these markets is expected to increase 14% for the second quarter of 2023 as compared to light vehicle production for the second quarter of last year.

For calendar year 2023, light vehicle production in these markets is forecasted to increase 4% when compared to calendar year 2022. Based on this light vehicle production forecast, the company is making no changes to its previously provided estimates for 2023. Revenue for the year is expected to be approximately $2.2 billion. Gross margins for the year are expected to be between 32% and 33%, and Operating expenses are expected to be between $260 million and $270 million.

Our estimated annual tax rate is forecasted to be between 15% and 17% and Capital expenditures are expected to be between $200 million and $225 million, and depreciation and amortization is forecasted to be between $100 million and $110 million for 2023.

Additionally, based on the company's current forecast for light vehicle production for calendar year 2024, the company expects calendar year 2024 revenue growth of approximately 10% above the 2023 revenue guidance range of approximately $2.2 billion.

Overall, the first quarter of 2023 performance was largely in line with our expectations as demand for our products was very strong which ultimately resulted in record sales performance for the quarter. Our teams continue to perform diligently to avoid supply shortages, and our focus on labor challenges has resulted in employment growth in recent months.

We believe these increases in headcount will provide our operations team some much-needed relief from the hectic build schedules we have experienced much of last year and will be critical in supporting the aggressive growth targets we are forecasting throughout the remainder of 2023 and into 2024. Our larger team is also critical to create the opportunity to reduce overtime, scrap and yield loss, which are needed to support our gross margin recovery initiatives.

Obviously, there remains a tremendous amount of work to be done to achieve the targeted margin profile, but I'm pleased with the progress made so far, and I have the complete confidence that the Gentex team has the capability, adaptability and grit to accomplish our plans.

That completes our prepared comments for today. But before we jump into questions, Josh is going to walk us through a short statement regarding our proxy.

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

Thanks, Steve. As you all know, we have entered into proxy season, and yesterday, we received Glass Lewis' summary report of our proxy, and we believe we need to address 1 concerning area in their report. Gentex is disappointed in Glass Lewis' recent recommendation to oppose the continued nomination of Ms. Leslie Brown to its board and strongly urges its shareholders to vote in support of Ms. Brown.

Over the past 6 years, Gentex has remained focused on identifying and nominating qualified, capable, intelligent thought leaders to our Board. During this time, we have onboarded 6 new members to our board with a wide variety of backgrounds, capabilities and experience. Of these 6 new board members, 2 have improved the Board's gender diversity and two have improved the Board's racial diversity.

The obvious conclusion here is that with 4 of our last 6 board member additions, improving diversity, we believe we've shown commitment and action toward a more diverse representation on our board. Glass Lewis' recommendation is based on the logic that it is the responsibility of the Chair of the Nominating and Corporate Governance Committee to achieve a 30% goal of gender diversity and clearly outline a time line for improving the Board's diversity, specifically with a focus on gender diversity.

It follows that without this time line, Glass Lewis is recommending against supporting the Chair's nomination to the board. This recommendation therefore, seeks to support gender diversity by advising a vote against one of Gentex's female Board members. In 2016, Ms. Brown was the first female board member in the company's history. And since that time, she has served with distinction, intelligence and respect.

In summary, we believe that while Glass Lewis' goals for Board diversity come from a good place, the recommendation against Ms. Brown shows a clear disconnect between their stated goals and any logical progress toward achieving said goal. In other words, we vehemently disagree with Glass Lewis' logic of abstaining votes for a qualified female candidate that has a successful record as a director for the company as a means of supporting or gender diversity.

Ms. Brown has served on the committee since 2018. And in her new role as Committee Chair, Ms. Brown is uniquely capable and qualified to lead this committee and remain on our Board. We encourage our shareholders to vote in favor of Ms. Brown.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ron Jewsikow with Guggenheim Securities.

Ronald John Jewsikow - *Guggenheim Securities, LLC, Research Division - Associate*

Just a couple of questions from me. How big of a benefit was mixed this quarter, taking things on the product side, like lower base anterior mirror shipments to China, maybe an increase in HomeLink and ITM and anything else you'd highlight?

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

Yes. It's a combination. When we look at mix, we talk about 2 things. You have the overall mix of products like you mentioned, how many advanced features versus base and outside versus inside. But then also you kind of taken -- there's also a factor in there, which is the overall growth rate. But you're around 50 basis points or so of benefit from mix.

Ronald John Jewsikow - *Guggenheim Securities, LLC, Research Division - Associate*

Okay. And then. Second half of last year, increased -- you increased wages quite a bit and I think had quite a bit of net hiring as well. Has that begun to have any benefits on the gross margin line in the form of reduced overtime or lower expedited freight or is that something we should think about as a source of upside maybe later this year and into 2024?

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

Yes. So labor costs in general, on the gross margin still, so a lot of the benefits happen in the overhead and operating expense side because expedited freight, outbound customers shows up in sales expense. So a lot of times the increased labor will lower gross margins, but it does give you some leverage in OpEx, but we're facing -- I'm looking at Kevin -- about 100 basis points of margin headwind on a year-over-year basis based on the higher wages.

We have seen overtime start to drop and probably the quickest benefit, though, to your point, has been the lower freight expense. And so as we get past the lower freight, then we'll start to be able to reduce overtime because we're still working overtime in order to build a little extra inventory on the finished goods side to get back to surface shipments versus air shipments, which is obviously going to help lower freight even more. And then ultimately, it will end in lower overtime.

Ronald John Jewsikow - *Guggenheim Securities, LLC, Research Division - Associate*

That's super helpful. And maybe just sneak in 1 more related to FDM for both you and Neil. Has your ability to secure new business wins has been negatively impacted by the supply chain environment over the last several years and with that starting to improve, do you think we could see an acceleration in new customer wins and announcements?

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

Yes. I don't think the supply constraints have negatively impacted the customer award side. I think it's been more just on being able to build enough parts and quantity and supply for the demand as we come out of that from a supply constraint and as we move forward, yes, we're not seeing -- I mean, we announced 94 launches that we've executed of Full Display Mirror. We see a continued growth and ramp in the product and not just in launch execution but also in volume.

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

Yes, I'd say the single biggest impact wasn't in awards to Neil's point, it was more in take rates. So over the last 18 months, there's been a lot of desire from OEMs to increase take rates and we just haven't been able to support that until now. Right now, we're sitting up in a really good spot when it comes to advanced electronic content for -- especially for FDM. So we're in a much better spot right now to support higher volumes than what we were this time last year.

Operator

Our next question comes from James Picariello with BNP Paribas Exane.

James Albert Picariello - *BNP Paribas Exane, Research Division - Research Analyst*

Good morning, everybody. I wanted to ask about the first quarter unit volume shipments, right, at $12.7 million, a quarterly record for you guys. What really drove that or does that reflect kind of max capacity within your current footprint? Or is this kind of set the stage maybe for you've invested, right? You've had capacity investments. Does this kind of set the stage for a new established bar going forward here for the rest of the year and beyond?

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

Yes, we're not -- we're pretty darn close to max capacity at these levels. We can do a little bit more, obviously, with some extra overtime. The real investment that you see this year and the step-up in CapEx and probably next year -- another year after that at slightly elevated levels, that's going to create the facilities we need and some of the equipment, and that we'll start to see some step function increases over the next 18 months in overall capacity.

So yes, we do have some additional equipment coming online this year. And then brick-and-mortar projects over the next 18 months to 2 years, we're going to help us really kind of increase that overall capacity of the company.

James Albert Picariello - *BNP Paribas Exane, Research Division - Research Analyst*

Got it. And just on that topic, is your light assembly plant in China, I don't know if you want to call it a plant, but your footprint there, is that also helping -- did that help drive this quarter's unit volumes in any way?

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

Yes. We've -- so we're absolutely executing final assembly now in the China market for the domestic China production. And so that has helped with additional headcount and additional equipment that is helping produce -- helping raise the production level as well. It's a fairly minor amount still, but we have expansion plans there and through some third parties that we continue to look at to help with the labor challenges, but also the geographical footprint of all of our products, making sure that we're able to get parts to and from our facilities here in a quicker way.

James Albert Picariello - *BNP Paribas Exane, Research Division - Research Analyst*

Got it. And then just my last question would be on -- and my apologies if you had referenced this, but just in terms of the chip supply, availability is dynamic, and how that plays into your ITM, your integrated toll module and of course, FDM. Is capacity -- is chip capacity constrained? Or is it more just your own in-house production and staffing capability now?

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

I'd say all the way up through the end of calendar year 2022 component availability was the biggest challenge. Now we feel really good about where we're at on the electronics side. Now it's more about capital equipment and labor internally would be the only limiting factor. But right now, we're able to keep up with demand, what OEMs are looking for with those.

So we're not short shipping or constraining FDM shipments right now based off of internal constraints either. So we feel like having survived obviously one of the larger quarters -- the largest quarter in company history and one of the largest from an FDM standpoint, we feel really good about how we're positioned to keep up with FDM demand throughout the year.

Operator

Our next question comes from Luke Junk with Baird.

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

To start, Steve, hoping you could and on what might be some of the less obvious aspects of the gross margin recovery initiatives at the company, such as overtime that you already discussed, but also things like scrapped [a new boss] that you're muscling up to address. And other words, maybe if you could just touch on the part of this journey that's not just the price recovery part, the part that is within your control really?

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

Yes. So like you mentioned, I mean, there's a portion of that that's going to be the price recovery piece that's going to be an ongoing target through the rest of this year. But the internal parts of it that matter the most are the higher levels of revenue, obviously gives us the opportunity to start to leverage overhead in a more effective way. We were able to do it with less overtime than what we've been -- over time, dollars and what we've been seeing in prior year despite the growth. So there's obviously some leverage that's created there.

And then we have -- with the team growing, we have had some struggles with scrap and yield loss. And that's -- and so that was not ideal operating conditions in Q1. However, it does create the opportunity for us over the next 9 to 12 months as these newer employees become more comfortable equipped and capable, we believe we can improve that scrap and yield loss category to further drive margin profile improvement.

And so it's one thing to get the team onboard, it's another thing to get them trained. And it's a totally different process that probably takes 3 to 6 months before the newer team members feel comfortable in the environment and very capable and highly effective. So we feel good about the team that we've put together, and we know with a little bit of time and our operations team's dedication, we'll be able to make improvements in those areas as well.

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

One more nuance that Neil mentioned in his section of the call is the VA/VE portion, right? So those redesign efforts intended to reduce bill of material costs through reengineering product, not only helps with less material or more tooling -- better tooling pricing but it helps with the margin that way versus just lower component costs.

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

Yes. And that will be really more like end of '23 and taking us into '24, the focus on further improvement through VA/VE activities. And that's why we talk about '23 and '24 as our total time line to get back to that targeted margin profile.

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

And then my follow-up maybe for Neil just to making the sense. Bigger picture, innovation seems really now to be happening at a breakneck pace in the China market, if we look at what was coming out at the Shanghai Auto Show this month. How do you think about leaning into that in terms of FDM in China, more richly contenting base mirrors or even emerging product categories for the Chinese market?

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

Yes. For the Chinese market specific, that one changes really, really fast. And what you see, and we talk a little bit about base mirrors, executing base mirrors into that market, and that's what we've been focused on for the last couple of years is continuing to grow that penetration. Again, this quarter, we had some -- another handful of base mirrors launching and executing into the China market. With any of our products, that said, that's the introduction that we have is get base mirrors in and then start adding features and content.

The market in China is moving and evolving really, really quick. And the team is focused on how to adapt our products to grow that footprint outside of just the JV OEMs that we've been working with and be more into the domestic side. But it does get into time, resources and then the financial side of that of making it into the business that we wanted to be.

So there's a lot happening, a lot evolving in the space, and we're kind of taking our time to make sure we're doing it right. And coming out of the component shortage, it's a time to start looking at that next phase.

Operator

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

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

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

Great to see the record sales for the quarter. Just looking here, I guess you're almost near the low end of the gross margin guidance for the year here in the first quarter. Is there much further action that you really need to take to kind of get to the targets that you have for this year? And then other things that you're doing as you try and move towards a more normalized gross margin profile for the end of next year that could further enhance it?

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

Yes. No, you're absolutely right. There's a lot of work that's going to be going on throughout the end of the Q1 through the end of the year to further improve margins. So this is why we wanted to start off by talking about the progress that's going to happen over the course of the next really 18 to 21 months. It's -- hopefully it may not be completely a linear improvement, but the goal is to continue to get better every quarter.

And so yes, there's a lot of action steps that we have in place. Some of them I just talked about a couple of questions ago being primarily focused on operational improvement as the team comes on board and helping with the training to help lower yields, scrap costs and lower overtime further.

Obviously, on the customer side, we have some pricing stuff we still need to work through with the customer base and those should be tailwinds to the margin profile as well. We don't expect those to happen all at one time. We think it is going to take a little more time and probably be evenly smooth throughout the year as we settle those negotiations.

And then beyond that, heading into 2024, we think at some point end of this year, beginning of next, we think we'll start to see some recessionary economics as it relates to pricing. So we're hopeful that we can kind of get back to a more normalized instead of cost increase environment into a de-escalating environment for materials.

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

And then I guess the last question for me. Growth in the first quarter, right, come in above right, the percentage that you're looking to 15% or so that you're looking for, for this year, and then 14% light vehicle production expected in 2Q as well bodes well. I guess like how are you thinking about the second half versus the first half, do you expect a material slowdown later this year? Or are you just becoming increasingly confident that you're going to be able to beat or surpass that 15% growth target this year? I'm just waiting for a little bit better visibility before potentially revisiting that?

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

Yes. I think the upside is obviously there. The risk factor is what are we dealing with? Is this a little R or a big R that's going to happen in the second half of this year? And higher interest rates, how are they going to impact the high-priced vehicle market. And so one of the things that we're very optimistic about is for the first time in a while, we had very consistent orders. It was one of the first quarters and probably a little over 2 years where the order volatility from the customer base improved. It's been so long and so chaotic that it's been honestly really hard to plan at all.

And so the team was able to get its legs under it a little bit more than normal. Obviously, it wasn't like prepandemic, where we could operate a week-long schedule, really without too much chaos. So we're not all the way there, but we're starting to make improvements in getting back to that area. So yes, I mean, there's definitely some upside there.

The Q2 production environment is a little overstated because of the chaos that happened last year in Q2 on the automotive -- on the auto light vehicle production side. So I don't know that it's going to correlate exactly. In other words, I don't know our outperformance is going to be stacked entirely on top of that 14 because there is the leading side of that, which is our sales are weeks ahead of when cars are built.

But for the first time in a long time, you're starting to see OEMs capacity start to increase as well, and that's a good sign for us because it hasn't just been the supply and the components and our own ability to keep up. It's also been OEM struggle to be able to get capacity back to where it was pre-pandemic. And we're starting to see some strength there in our customer base.

So it's pretty exciting. We're just hoping that the macroeconomic portion of this doesn't have a huge impact on the back half. Obviously, by the time we post Q2, we'll have a better sense for that. In other words, what does the second half of the year going to look like. And there is -- I would say there is an opportunity to do slightly better than what our forecast was.

As the last 3 years have taught us though, there's always a massive opportunity for it to be worse than expected as well. So call it a little worn out from getting punched on the ropes, but I think we're just hanging -- we're happy that we had a great sales quarter. We're pretty optimistic about Q2 being good as well, and we'll see what the second half brings.

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

Well, fair enough. Great to see the supply chain environment improving and the opportunity for stuff like FDM to get back to normal or above normal trends.

Operator

Our next question comes from [Frederico Morandi] with Bank of America.

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

It's John Murphy. Can you hear me?

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

We got you.

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

Yes, sorry for the technical difficulties before. One thing you made a statement, it's actually very interesting and very enlightened in -- you need a larger team to take cost down, which is kind of the opposite of what a lot of people think of the world these days, you need less people and have them do more and more. So it's very interesting. Could you outline what the overtime costs are, how bad their scrap has been and yield loss has been maybe relative to history, if you can't put dollar terms on that? Just kind of give us an idea of like how much overtime you're running that might go away, how bad scrap is relative to the history and yield has been versus history?

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

Yes. So I'll start kind of with a generic answer, and I'm sure Kevin will jump in with some details. But if you look at over time, really over the last 18 months, we've been running probably at about 2x the amount of overtime that we would have normally expected. So there's a healthy amount of overtime. Obviously, there are certain amount of employees who like that over time, and there's a certain amount of it that helps you take advantage of CapEx in your footprint. Unfortunately, over the last 18 months, it's been way beyond that. And so that's why we look at overtime as one of the key drivers of savings over the next 12 months.

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

Yes. So I think really to just tailor in on that. If you look at that incremental headcount, which is probably about -- we've added close to 400 to 500 teammates on the hourly production side over the last year. If we're that short, we were trying to build -- have sales in this $450 million to $500 million range a quarter. We were really -- we were running incentives at last year at this time that we're paying 2x to 2.5x overtime premium.

And so then you're getting a lot more cost from a unit perspective. And so at this time, we have just straight over time primarily that's happening because of the higher headcount, once you improve productivity, you get down the normal 45-hour work weeks, that's really what -- where the opportunity exists.

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

Got it. And the yield loss, I mean how bad are yields as a result of that or other inefficiencies?

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

Yes, they're not -- it's not like horrible, but when you're talking about the last couple of percentage points of yield or a yield loss in this case. On a revenue of this size, you start to talk about a couple of million dollars or a few million dollars in savings potential that are out there. And so these are the types of things that we need to get really good at and make improvements in to get back to that kind of ideal state on the margin profile side.

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

Okay. And then just lastly on the international shipments. Can you tell us how many or what portion is in China at this point and maybe what it was last year in the first quarter, just so we have an idea because it does sound like that's a huge opportunity for you over time.

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

It's still right around 8% to 10% of total shipments, total revenue for the company. Shipments continue to be higher because it is a higher mix of base. So that's probably closer to the 10%, revenue is probably closer to 8.5%. But it's really driven by the -- outside mirror growth is driven in a lot of the growth with Tesla and then some of the other EV manufacturers growing outside mirror volumes in that market. But it's still kind of at 9% of revenue because it's primarily base mirrors.

Operator

Our next question comes from David Whiston with Morningstar.

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

For Steve, I think you were hinting in an accounting difference. I just wanted to clarify, is expedited freight and COGS and then regular freight is in SG&A?

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

No, the shipment -- the incoming is in bill material, so it's in COGS. But when you're shipping to your customer, it's in sales -- selling expense. So when we're talking about freight improvements, when we're talking freight improvements, you're talking about freight on the incoming side, which will improve gross margins, but the selling expense will show up in operating costs, not in bill materials.

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

Okay. You had improvement in both, you said?

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

Yes, we did have improvements in both, yes.

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

Okay. On the press release, you called out an increase in staffing and also in professional fees. Is the staffing increase more on the ROE versus corporate side? Or is it balanced? And then what type of professional fees are you increasing spending on?

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

Yes. There were increases in both, but the statement that you're reading there is in relation to operating expense. So that's really on the professional side. So it's more about engineers, development teams and outside consulting as well to help keep up with the launch rate and some of the new products we're working on.

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

Okay. And then I guess, just one more question. In terms of the -- as you know, the ongoing macro uncertainties and it's kind of a mixed signal, some things are good, some things are bad. But are your customers still really focused on very next stage type of products that we haven't seen in vehicles before like much larger dimmable surfaces? Are they being a bit more cautious now and just focusing more on the present due to macro fears?

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

Well, it's actually -- we haven't seen a slowdown in their interest in new technology due to recessionary fears. In fact, I would say we've seen a pickup in interest and engagement as OEMs have gone back to the office, it's actually increased the R&D -- from an R&D standpoint, the ability to talk about new product development and execution.

I'd say that was one of the hardest things during the pandemic. It was -- when people were working from home, it was really tough to show a prototype of a brand-new product or discuss even the theory of what a vehicle of the future could look like. So that was a difficult selling environment.

I would say that part has improved a lot. We're getting back to customer visits, and we've had a lot of OEMs coming to Zealand to visit and see our R&D facilities and some of our new product concepts. So we haven't seen any negative headwinds yet due to recessionary fears in terms of new R&D or product efforts.

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

Okay. And just lastly on the airplane window growth, it was really good. Is that primarily more Airbus production starting or any growth from Boeing?

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

There was a lot of Boeing there. We were always cautious about putting that percentage in because it was pretty much zero this time last year. So it did improve a lot, which is a good sign, but we're actually running pretty consistent production right now in our aerospace area. So it's good to see that area coming back and obviously, getting back to producing. Airbus has started to pick up a little bit, but the vast majority of those sales are still Airbus -- I mean, it's still Boeing related.

Operator

This concludes the Q&A session. I'd now like to turn it back over to Josh O'Berski for any closing remarks.

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

This concludes our call. Thank you, everyone, for your time and questions, and have a great weekend.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.
