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GNTX.OQ - Q2 2021 Gentex Corp Earnings Call

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OVERVIEW:

Co. reported 2Q21 net sales of $428m, net income of $86.5m and diluted EPS of $0.36. Expects 2021 revenue to be $1.88-1.98b and 2H21 revenue to be $0.970-1.07b.

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Gentex Second Quarter 2021 Financial Results Conference Call. (Operator Instructions) Please be advised that today's conference may be recorded. (Operator Instructions).

I'd now like to hand the conference over to Josh O'Berski, Director of Investor Relations. Please go ahead.

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

Thank you. Good morning, and welcome to the Gentex Corporation Second 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.

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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 second quarter of 2021, the company reported net sales of $428 million, which was an increase of 86% compared to net sales of $229.9 million in the second quarter of 2020.

On a quarter-over-quarter basis, global light vehicle production in the company's primary regions of Europe, North America, Japan, Korea and China increased 36% when compared to the COVID-19 impacted second quarter of 2020. However, when compared to the mid-April 2021, IHS Market vehicle production forecast in the company's primary regions, actual light vehicle production in the second quarter of 2021 declined approximately 1.1 million units or 7% as a result of industry-wide part shortages and global supply chain constraints.

The largest deviation from the forecasted production within the quarter came in North America, which saw an actual light vehicle production decline in excess of 15% compared to the mid-April 2021 forecast. The reduction in light vehicle production compared to forecast was led by certain OEM customers that deploy high levels of the company's product content, including both interior and exterior auto-dimming mirrors and other electronic features such as Full Display Mirror and HomeLink.

In total, the impact from the shortfall in vehicle production compared to forecast led to an estimated mirror unit shipment reduction of approximately 2 million units versus the company's beginning of the quarter expectations. While we are very pleased with the net sales increase of 86% over the COVID-19 impacted second quarter of last year, we are still experiencing tremendous volatility and order cancellations as our customers continue to deal with the impact of the ongoing part shortages that are affecting our industry.

The initial forecast for the second quarter was for sales to be one of the largest quarters in the company's history, but the continual changes in releases and orders resulted in the push out of approximately 2 million units. The unit shipment changes were most severe in North America, where our dollar content per vehicle is above the corporate average. We estimate that the total impact to revenue in the quarter was about $80 million. As we move through the second half of the year and into 2022, we are encouraged that the overall demand for vehicles and our products should still provide opportunities for the company to continue to outperform the underlying market.

For the second quarter of 2021, the gross margin was 35.4% compared to 19.1% for the second quarter of 2020. Compared to the COVID-19 impacted second quarter of 2020, gross margins improved due to higher sales levels, significantly better overhead leverage, the structural cost savings put in place by the company last year and positive product mix. While the gross margin for the second quarter of 2021 improved significantly versus last year, it was well below our initial estimates for the quarter.

The lower-than-forecasted gross margin was primarily driven by the significant reductions in expected sales during the quarter, our inability to offset fixed and variable overhead costs due to the lower sales, lower-than-expected price reductions on raw materials and higher-than-expected incoming freight costs. The good news, however, is that despite many of the challenges in the quarter, our analysis shows that if sales had hit our initial forecast, then gross margins would have been very close to our previous annual guidance range.

Operating expenses during the second quarter of 2021 increased by 2% to $51.7 million compared to $50.7 million in the second quarter of 2020. Income from operations for the second quarter of 2021 was $99.9 million compared to a loss from operations of $6.7 million for the second quarter of 2020. During the second quarter of 2021, the company had an effective tax rate of 15% or $15.3 million, which was below our annual guidance range and was primarily driven by the benefit of the foreign-derived intangible income deduction and discrete benefits from stock-based compensation.

Net income was $86.5 million for the second quarter of 2021 compared to a net loss of $2.4 million in the second quarter of 2020. The increase in net income was driven by the quarter-over-quarter increases in sales, gross margins and operating profits. Earnings per diluted share for the second quarter of 2021 were $0.36 compared to a loss of $0.01 for the second quarter of 2020. The increase in earnings per share is the result of the higher net income when compared to the second quarter of 2020.

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

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

Thank you, Steve. Automotive net sales for the second quarter of '21 were $420.6 million, an 89% increase compared to $222.1 million for the second quarter of 2020. Auto-dimming mirror unit shipments increased 98% during the quarter, highlighted by 140% growth in exterior mirror unit shipments compared to the second quarter of 2020. Other net sales in the second quarter of '21 were $7.4 million, a decrease of 6% compared to $7.9 million in the second quarter of 2020.

Within that, fire protection sales increased 31% quarter-over-quarter, while dimmable aircraft window sales decreased by 65% comparatively. The company expects that dimmable aircraft window sales will continue to be impacted until there is a more meaningful recovery of the aerospace industry and the Boeing 787 aircraft production levels. During the second quarter of '21, the company repurchased 3.4 million shares of its common stock for a total of $115.9 million.

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'll now highlight some key balance sheet items as of June 30, 2021, as compared to December 31 of '20. Cash and cash equivalents decreased to $353 million, down from $423.4 million, primarily due to cash flow from operations that was more than offset by share repurchases, dividend payments and capital expenditures. Short-term investments were $13.8 million, down from $27.2 million and long-term investments were $193 million -- $193.4 million, up from $162 million.

Accounts receivable decreased to $234.1 million from $284.9 million due to the decline in sales. Inventories were $263.9 million, up from $226.3 million. Accounts payable increased $101.3 million, up from $84.8 million, primarily due to month-end payment timing. And accrued liabilities were $95.1 million, up from $92.9 million and increases were due to higher accrued salaries and wages as well as accrued income taxes.

Now quickly looking at the cash flow statement. Second quarter 2021 cash flow from operations was $62.4 million, up from $39.2 million in the second quarter of last year. But the increase in operating cash flow was driven by increases in net income but partially offset by fluctuations in working capital.

Capital expenditures for the second quarter were $18.8 million compared with $13.3 million for the second quarter of 2020, and year-to-date capital expenditures were $31.4 million for '21 and compared to capital expenditures of $28.8 million in 2020. And depreciation and amortization for the second quarter was $25.9 million compared with $27.1 million in the second quarter of 2020, and year-to-date was $51.5 million compared to D&A of -- for 2020 of $53.4 million.

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 second quarter of 2021, there were 29 total launches of our interior and exterior audited mirrors and electronic features. Of these new launches, 45% contained advanced features with Full Display Mirror leading the way.

Now for some updates on Full Display Mirror. We're excited to announce that during the second quarter of 2021, the company began shipping Full Display Mirror to our ninth OEM Maserati. The Maserati MC20 now has Full Display Mirror, and we're excited to continue to grow this product across other vehicles in the future. Also during the second quarter of 2021, we began shipping Full Display Mirror on the Jaguar XF and the Buick Envision for the China market.

We are now shipping Full Display Mirror on 56 vehicle nameplates and are forecasting at least 10 new vehicle nameplate launches for the second half of 2021.

It's been a few quarters since we provided an update on the number of OEM customers that have awarded us Full Display Mirror programs. As of the end of the second quarter of 2021, we have been awarded Full Display Mirror programs with 14 OEMs, and we'll be announcing OEM 10 and 11 in the second half of this year. OEMs 12 through 14 will be launching and bringing to market the Full Display Mirror product over the next 2.5 years. Even with the unique market situation we have been all facing, it's clear that our OEM customers and consumers value the benefits that a Full Display Mirror system provides to enhance railroad visibility and driver safety.

In summary, even with the current challenges our industry is facing, our product launches, product rollouts and new technology developments are continuing to help propel the company forward, and we're excited to see the impact of these over the coming years.

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 half of 2021, and full years 2021 and 2022 are based on the mid-July 2021 IHS Markit forecast for light vehicle production in North America, Europe, Japan, Korea and China. Light vehicle production in the company's primary markets is forecasted by IHS Markit to decrease 4% for the second half of 2021 versus last year. This forecast from IHS Markit assumes that many of the supply chain-related issues that began at the end of the first quarter of 2021 and continued throughout the second quarter of 2021 will improve during the second half of the year.

While the vehicle production volumes are a reduction versus second half of 2020, this forecast represents a 9% increase in light vehicle production when compared to the first half of 2021. Based on this light vehicle production forecast, the company is providing guidance estimates for the second half of 2021. Given the significant changes in vehicle production volumes in the second quarter and the associated impact on the company's actual results and the challenges in our current operating environment driven by supply chain and freight issues, the company believes that guidance specific to the second half of the year is more accurate and indicative of actual performance for the remainder of the year than only providing full year 2021 updated guidance.

The company also believes that this approach may help provide a more accurate projection for calendar year 2022 performance. The company's current estimate is that net sales for the second half of 2021 will be between $970 million and $1.07 billion. This revenue forecast is based on the IHS Markit light vehicle production forecast for the second half of 2021, but also includes manual adjustments to the company's forecast as a result of customer order changes, stemming from part shortages that have impacted the second quarter and will likely continue to impact demand into the second half of this year.

The company has also updated our cost and profitability model to include impacts due to elevated raw material prices, freight expenses and labor costs. The following guidance is intended to replace our previous guidance. Revenue for the second half of 2021 is expected to be between $970 million and $1.07 billion. Gross margins for the second half of 2021 are expected to be between 37.5% and 38.5%. Operating expenses for the second half of 2021 are forecasted to be approximately $105 million to $110 million.

Our estimated tax rate for the second half of 2021, which assumes no changes to the statutory rate, is forecasted to be between 16% and 18%. Capital expenditures for the second half of 2021 are expected to be between $50 million and $60 million. Depreciation and amortization for the second half of 2021 is forecasted to be between $54 million and $59 million. Based on the mid-July 2021 light vehicle production estimates for 2022, the company estimates that revenue for calendar year 2022 will be approximately 10% to 15% higher than the updated 2021 revenue estimates of $1.88 billion to $1.98 billion.

We have updated our 2021 and 2022 guidance to include our expectations that the company will continue to see headwinds to demand due to supply shortages that we believe will continue in the second half of 2021 and into the first half of 2022. Our forecast includes manual adjustments to the IHS Markit forecast for light vehicle production. Despite the massive volatility in the industry, we are estimating that build-up demand will provide strong revenue growth next year that is on pace with our initial revenue guidance for 2022.

Our industry is enduring severe challenges currently, including issues in order cancellations, component shortages, raw material increases, freight issues, labor shortages and other pressures. But we remain optimistic that the next 18 months has the potential to produce record-level revenues and profitability for the company.

In conclusion, I'd like to take just a minute to thank the entire team at Gentex for their focus, hard work and immense flexibility during the quarter. The amount of last-minute changes in customer orders, combined with the difficulty in receiving raw materials and the necessary volumes and timing made it very difficult to plan operations. But the team coordinated and worked very hard to keep up with the rapidly changing environment, which allowed us to continue our streak of meeting customer shipments without any major downtime for our customers.

We believe the challenges facing our industry will continue for at least another 12 months, and our forecast assumes that overall light vehicle production will continue to see large changes and increased volatility. These headwinds will also continue to affect the overall profitability of the company, but much of the work we did last year on cost controls has prepared us for the difficult conditions we are currently operating under. Despite these challenges, our forecast for the rest of 2021 and 2022 remains strong.

As I mentioned during the first quarter conference call, 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. 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) Our first question comes from James Picariello with KeyBanc Capital Markets.

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

Can you start by maybe just quantify the actual semiconductor and premium freight costs in the quarter. I believe the number was $6 million or so last quarter, so curious how that trended. And then can you share what you now have baked in for the second half? Does the cadence alleviate by the fourth quarter? And how should we start thinking about these extraneous costs persisting next year within the cadence for the second half?

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

Sure. So the -- what we've seen in the first half is a little lower than what we're expecting in the second half. But if you look at kind of what the premium, the premium is on electronics right now versus what it would have been last year. The first half of this year is probably 50 to 100 basis points. The second half, we're expecting to be 100 to 150 basis points, and that's talking gross margin impact. The freight is right around 100 basis points on the gross margin. And just to point that out, that's all incoming freight costs, which is what impacts the gross margin line. There's also expedited freight costs on the outgoing, which affects our sales expense.

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

Okay. Got it. And then as we think about next year then, is the second half gross margin guidance of 37.5% to 38.5%. Is that a good starting point in terms of thinking about gross margins for next year?

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

Yes. We think that's pretty much probably going to be in line. The only reason why we say that is a very volatile environment when it comes to pricing on the semiconductor side. But we believe most of the negative impacts will be hitting in the second half of this year. So we don't expect additional starting in 2022 at this point.

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

Okay. And just a follow-on to that. I mean what are the levers that could swing that one way or the other in terms of you'll have your annual price reductions with your OEM customers at the start of the year and then you'll be, what, negotiating on the -- on your supply on your trip supply base to get concessions there. Just how should we be thinking about the dynamics?

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

Yes. I think -- I mean the single biggest dynamic and the single biggest negative impact this quarter was just the lost sales. So really, the thing we're watching the most is unfortunately somewhat out of our control, but that is what other Tier 1 suppliers are struggling that are causing OEM downtime issues. If the OEMs are up and running, based on our forecast, we're going to be in great shape throughout the second half and head into next year. So that would be the single biggest thing to watch is how close do we come to our revenue estimates. From there, it's about the factors that you mentioned, right? How do lengthening of time to get parts into space, how do we get them into our facilities and then at what price point? So if we can handle that first half and sales actually hit, then we feel pretty confident in our ability to manage the expenses around the price increases and the freight expense.

Operator

Our next question comes from Luke Junk with Baird.

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

So first question I want to ask is on China. So you said that China sales increased significantly in both the first and second quarter now. So it does seem like we're seeing some sustained momentum there. While I know it was a negative for mix this quarter, if we take a step back and look at the company's strategic positioning in China, wondering how you're feeling about that today versus, say, a year or 2 ago? Or do you feel like you're on the front foot in China now?

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

Yes. So I would say we're definitely making great progress in the China market. If you back up 5 years ago, I'd say we were a little bit behind in the China market versus where we should have been. And so in the last few years, especially, we've made tremendous progress. So these are -- what we're launching and the sales increases were awards that we were given 2 to 3 years ago and just going into production now. So we're definitely excited about that, the opportunities of the China market, and it's good to see their production levels returning to normal.

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

Next question I wanted to ask is in terms of the disclosure that you gave us on the 14 OEMs that are now on board for the Full Display Mirror, so I know we're not going to get into anything specific here, but I'm just wondering if there's anything in way of commonality for looking at geography, market segment or similar? Just trying to get an idea of where you're seeing momentum in terms of bookings on the FDM.

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

Yes. Actually, it's broad spread. You see markets and luxury vehicles down to volume vehicles and everywhere from standard fit on a vehicle to optional take rates. So it's -- I wouldn't say that it's a particular segment or a particular region because we've got vehicles that have launched in China with it. The Buick and Vision Plus is a Chinese market. We've got Japanese-based products. Europe has been picking up for the European market. And of course, North America is where a very large portion of it is. So we're seeing growth in outside of North America lately.

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

Great. And if I could just sneak one last question in on gross margin. Hoping to put it in context of your second half guidance relative to sort of the typical seasonal pattern that we'd see at Gentex. And specifically, what I'm wondering is, to what extent can the normal activities that you would undertake to offset annual price downs help to address these pressures that we're seeing right now in terms of material and freight costs?

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

Yes. I think we are seeing -- still have positive cost reductions, but the electronics content is kind of muting it out a little bit to that tune of about 100 basis points or 150 basis points, in some cases. So that's really what is offsetting kind of our seasonal ramp. Now if sales come in, as forecasted, that should help offset it. But I think we're talking about a little bit of a discount to what the IHS forecast is showing. So that also was a negative -- a little bit of a negative on the gross margin that would -- that should -- would be offset in the second half.

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

Yes. I think to Kevin's point, I think the big increase from Q2 actuals to the second half guide, really, what you're seeing there is the impact of the higher sales levels that we're anticipating in the second half of this year.

Operator

Our next question comes from Ryan Brinkman with JPMorgan.

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

We've heard from a couple of other suppliers that the recent industry backdrop has been distracting as management time and attention has had to be diverted away from long-term projects and initiatives instead toward putting out various fires like figuring out increasingly tricky logistics and sourcing. I know you guys seemingly more than most other suppliers are always working on long-dated projects, skunkworks like medical, et cetera. And so I thought to ask about your experience and continuing to execute against your long-term projects, including new products under development, the ability to pitch new ideas to customers who made themselves be distracted, et cetera. I guess what was your experience kind of walking and chewing gum in the second quarter? And then how do you see the outlook for the same in the back half?

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

Yes. It's actually a great question, Ryan. Thanks for asking. As you can imagine, the backdrop is distracting. However, we continue to make great progress on those skunkworks type projects that we always have going, a lot of those are looking at verticals outside of our traditional vertical, and we feel very comfortable in our ability to continue to do both of those at the same time. The one thing I'll point out is on our existing book of business, having a forward-facing conversation with an OEM, whether that's an aerospace or in automotive, it has become more difficult not just because of the environment, what's going on in part shortages and downtimes but also because of the lack of travel and ability to go internationally and see our customers face-to-face.

But that hasn't stopped us. Our sales teams on the ground in those countries have done a great job continuing to show the new product concepts and what we're working on. What we're excited about in the second half of this year and heading into next year, we're fully anticipating being able to do CES again. And we're pretty excited to be able to show some new product concepts at that show.

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

Okay. Helpful. And then just what has been the early experience here in the first few weeks of 3Q relative to the supply chain constraints that you've talked about, the volatility in the customer production schedules, et cetera. Are you seeing any or do you expect any improvement in these issues in 3Q versus 2Q, perhaps on the cycling past of the Renesas fire or any other issue? I was just curious if maybe you said some of the customers that were negatively impacted had higher take rates, et cetera. I was just thinking, I don't know, F-150 or anything like that. And maybe those customers that were disproportionately impacted in 2Q, maybe that was because of Renesas and there could be some improvement. I don't know what you're seeing.

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

No. I mean, really, what we're seeing in July is pretty much a continuation of what second quarter looked like. So what we're -- what we believe will happen is the issues will continue to exist in the second half and then into next year, hopefully, just not as dramatic. In other words, Ford being down for as long as they were -- some of the other Detroit 3 really struggling with communication and data. I think what will happen in the second half of this year is not that there won't be problems. And when we talk about problems, it's not really limited to one supplier. It's really kind of rolls every day. You find -- get a call, it's a different supplier, a different problem. And so unfortunately, it's inconsistent. You have to adjust each one of them. But one of the things that we believe will happen and has starting to happen is communication and the industry is getting better. So the suppliers are communicating with OEMs more effectively.

Our suppliers are communicating with us more effectively. And if nothing else, that gives you a better chance to plan and to react. So even though we believe there'll continue to be shortages, we think the amount of time you have to spend on it will start to shorten.

Operator

Our next question comes from David Kelley with Jefferies.

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

Maybe just starting with the advanced feature take rate. It was a bit more resilient than we expected just given the ongoing headwind. So just curious what you're seeing customer's prioritize. And has that or do you think that's changing into the back half of the year given the lingering disruptions?

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

Yes. I think most OEMs in general, especially at the end of Q1 and really throughout Q2, if they had a preference, they're going to build the highest end vehicle they can. And that's been an interesting transition. There's been a lot of vehicles, and there's a lot of articles about this, where OEMs are dropping certain features. If they can't get the support from the supply base to produce it, they'll build the vehicle still maybe with 90% of the content that it would have had. So the bet is towards the high end. But by the second half of this -- of the second quarter, really, so into May, June, what you started to see were OEMs basically saying, "Okay, what can you give us, if anything, right?

Now it's we prefer to build high end, but to be honest, we'll build anything as long as we can get components. So I think there was a certain level of desperation at the end of the Q2 for all of us on the supply in the OEM side, just trying to put together a plan of what can we get you that will allow you to build a vehicle in general. And so I think there's a little bit more of that we have to get through here in Q3. And then hopefully, it gets a little better in the back half of the year.

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

Okay. Got it. That's helpful. Maybe just a follow-up, a medium-term question, but is there better visibility than average to the out-year, kind of the advanced feature take rate if we think about dealer inventory levels where they're at and OEMs scrambling to content vehicles. Just curious if the medium-term visibility could perhaps even be better than we'd historically see despite some of the shorter-term headwinds that are out there.

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

Yes. I think OEMs are doing a better job of trying to provide you information about what their intentions are and what they want to build further out to help with this issue of planning. The problem is that so far, that information hasn't been very useful because it's too optimistic. And unfortunately, the supply base can't support those levels. So as much as everything, like I mentioned, the communication is improving, unfortunately, it hasn't really turned into reality yet. But I think in the next 12 months or so, that will start to turn the corner. And the information that's being provided will be quite useful.

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

Okay. Got it. And then maybe one last one, if I could sneak it in. A potential FDM competitor announced a significant ADAS acquisition last night. So just curious if you have or maybe you are seeing any changes in the FDM competitive landscape or prioritization by potential competitors that are out there?

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

No. We don't think that acquisition changes the FDM landscape at all. I mean if you look at what that's focused on, it's a totally different technology and it isn't really in our feature set of any of our FDM products.

Operator

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

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

Had a question about the second half. And I'm certainly not trying to give you guys a hard time because this is very volatile time, and it has nothing to do with what you guys are controlling at the moment. But I mean how comfortable are you with these volume forecast going forward? I mean because -- I mean we are hearing -- and I'm sure you're hearing conflicting use of like chips are coming back. But maybe they're not depending on who you're talking to, and maybe volumes are increasing. But some of that volume increase is being allocated towards consumer electronics and cell phones more than the auto industry, so supply actually really might not be getting better in the second half of the year.

And it seems like despite there not being a lot of chips around, there was almost some pull forward. And I think you actually kind of just alluded to this from the third quarter into the end of the second quarter, but then that started to dry up at the end of the second quarter. So it's just -- there's just a lot going on here, and there's not a clear picture as to exactly how the chip shortage is going to resolve itself in the second half of this year. Hopefully, it will next year. I mean how confident are you in these numbers for the second half? And once again, I'm not giving you a hard time because this is the volatility in the semis industry, not the autos or even what you can control.

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

Oh, no. It's a good question, John. And yes, we're not offended by it. In fact, it's a million-dollar question that we're trying to answer every day. What I would say is if we do a bottoms-up forecast based purely on IHS Markit, our estimates for the second half would be much higher. We reduced those based off of the change in demand that we're seeing from our customers. So we got a pretty good quarter. I mean, I must say, a pretty good quarter, pretty good information in the quarter, at least, to give us some indication of how much volatility and likely order changes. So what we are also comparing that against is what are we hearing from our suppliers on the silicon side in terms of what can they hit in the second half versus the constraints they had in the first half. And so we do see some lightning. That also includes a tremendous amount of work that our team has done here to change product concepts and designs to make sure we're getting out of more constrained components and into others.

So in the background of all this, we've been doing a tremendous amount of work on redesigning circuit boards, relaying out designing around components that have more availability. These are all very quick turn engineering projects, expedited testing procedures and then obviously coordinating with OEMs on approval for all that. So it's not just that we're sitting and waiting for supply to get better. We're also actively redesigning products to try to get out of those constrained areas as much as possible. And that's what gives us a little more confidence in the second half than what we had in Q2.

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

Got it. Okay. That's very helpful. And then the second thing on the variable cost side, I mean, obviously, if you had better visibility and even if schedules were not good, but if they were steady and predictable, I would imagine you could respond a whole lot better than you did in the second quarter. I mean if we saw something more normally in the second quarter as far as the shipments that you saw with some level of predictability, what is your ability or how could you view reacted on the variable cost side that would have been much more effective than what you got jammed with, with the variability.

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

Yes. If you look at -- I'll kind of combine 2 things. One of them is what is the profitability of the lost business plus the overhead benefits if we could have planned better and just having better leverage. And that would have been 200, 250 basis points by itself, between those 2 areas. So that's why we look at the second half saying we don't need it to be a record-setting quarter from a revenue standpoint to get back to that profitability measure we gave despite the headwinds on the raw material side and freight. What we need is just enough visibility and then high enough level of sales that gives us that leverage point.

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

And then just lastly on the raws, it sounds like they didn't go up, but they were not -- they were a little bit worse than you were expecting in the quarter. As you look at the second half of the year, I would imagine, I mean, you're saying that they're getting a bit tougher in increasing. As you go into 2022, is that still an issue in the first half and it might ease in the back half of the year? I mean there's -- once again, it's another volatile factor, but it does seem like as supply comes on there on the raw mat side, you may actually get some easing sometime in 2022. What's your take on that? And what's happening in the near term? And what's your take without giving that guidance for 2022?

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

Yes. We're estimating -- sure. Yes, the second half of this year, we're estimating, and really into next year, about 100 to 150 basis points of gross margin headwind based on raw material increases. And that includes the semis, but it also includes a lot on the metal side and the precious metal side that affects our coding and a lot of what we do on the display side. So that's kind of our estimates for the second half and next year. We don't really see that easing anytime next year. We think 2023 would be the first time before you'd start to hopefully have some stability and then more normal type conversations around long-term productivity from the supply base.

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

I'm sorry, on a comparison basis, so this kind of pressure would consist -- would continue into the first half of 2022. Then on a year-over-year basis, would that potentially ease because you're already seeing it? Or you expect to...

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

Yes. On a year-over-year -- on a comp basis, absolutely because we're expecting a lot of that to hit in the second half of this year. So in the second half of next year, you'd already have some of that incorporated into your cost structure, so you wouldn't expect a full -- in Q4, in essence, next year, you wouldn't expect a full 100 to 150 basis points again. It would just be the -- whatever changes in the second half of next year.

Operator

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

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

I know there's a lot of uncertainty around the semiconductor supply chain right now. But clearly, you guys are seeing a lot of traction with the Full Display Mirror offering, a lot of new nameplates that are launching here. Are you in a good position? Any impact there as far as your ability to continue to supply those offerings? And it's also been a very favorable gross margin contributor. Is there any major impact there? Is there still a lot of favorable gross margin impact that you're seeing in that business? And just curious about the growth trajectory there and the margin profile, if there's been any change on that business.

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

Well, on the product side, FDM is one of the more challenging products because of the amount of electronic content in that product, so getting components and then also making sure you're managing through the headwinds on price increase side. So LCDs, especially drivers for LCDs have been -- it will continue to be, really for the next 6 to 12 months, a cost issue as the industry is facing cost increases on those type of components, but also, obviously, on the large end microprocessor side, which is inside all of our FDM products. So that product has been incredibly popular. At the same time, it's difficult to get those components, and then it's one of the challenges controlling the cost structure of that product as well.

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

But as we continue to launch FDM, we're typically moving out of base mirrors into FDM, which has a higher price point and does have higher margins overall. So incrementally, it is a benefit to the corporate overall margins.

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

And that we'll continue to see despite these issues. Thanks, Kevin.

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

And then just separately as a second question here. I know that you trimmed your -- the IHS estimates a little bit. I assume as far as geographically, is most of that cutting that you're seeing in North America relative to outside the U.S. And then while supply is a little bit challenged right now, it seems that there's very low inventory levels, right, overall. Curious about your take whenever we think a little bit more about next year as hopefully things start to normalize to some degree, how long it may take for these OEMs to kind of rebuild the inventory levels, given that the demand for vehicles is actually quite high right now?

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

I think you're 12 to 18 months before OEMs can reasonably get back to the inventory levels they would like to be at. Like you said, from a backdrop standpoint, it's actually exciting. I mean there's very low inventories, which, historically, in our industry, problems have always been around too high of inventory levels and what impact does that have. So honestly, I can't tell you the last time inventory levels have been this low. So that, if you look at the big picture, the fact there's low inventory levels and great demand from the consumer side and also for our products, in particular, that's what gives us the confidence that in the next couple of years should be a great opportunity for us to continue to grow and focus on profitability.

The bigger picture is when does it finally start to lessen and when can OEMs start to play catch up. The other issue is even if suppliers catch up immediately, it's difficult for an OEM to ramp up capacity in a short time period. And so I think that's the one that we would tend to say is going to take much longer for inventory levels at the OEM level to get back to where they would like them to be.

Operator

(Operator Instructions) Our next question comes from Mark Delaney with Goldman Sachs.

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

I guess first on the input cost increases that you talked about and some of that potentially being sustained into next year. Could you talk about what capability you think you may have to be able to pass some of these higher costs in terms of raw materials and freights on to OEMs as you start going through these negotiations and perhaps neutralize the impact to your margins as you think about 2022?

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

Yes. Typically, I mean, we're a market-based pricing company. So a lot of -- we don't have contracts that would dictate if raw materials go up by 10% that we get to pass those along. But every year is a new year from annual customer price reductions negotiations. And so putting those cost increases into our argument as far as like negotiating lower price downs is typically our best argument in how we approach it on an annual basis. So we have those conversations. We're having those conversations about last year still in some OEMs because, obviously, volumes didn't live up to the expectations. And so that's really our best chance of kind of offsetting the increase in raw materials is getting a lower price down on average at a given customer going into next year.

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

Got it. That's helpful. And then in terms of the outlook the company was giving around light vehicle production expectations for 2022, I believe the number of units the company is expecting is pretty similar this quarter compared to what you had last quarter around $76 million. And you're talking about the potential for some of these chip shortages to be sustained and still causing some degree of difficulty next year. So is that something you're already trying to bake in even last quarter into the '22 outlook and that's why it hasn't changed? Or are there some other puts and takes that are allowing you to maintain a similar volume outlook for 2020.

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

Well, the published IHS numbers, we didn't change those and changed that in our press release, but we're talking about our top line forecast that we're discounting that. And when we provide our revenue guidance, it's got our internal kind of manual adjustments in there. So we still publish what IHS is for the regions just for a benchmark. But just anecdotally talking about, we're discounting it so that it helps with the modeling going out.

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

Got it. That's helpful. And maybe just one last one. As you're thinking about the second half of the year, you've already given some helpful color on how you're hearing from customers about the build schedules and how that may ramp up. But if you jump a little bit more about the linearity in the second half builds in terms of where you are running at today and how this starts to improve, understanding it's still tight throughout the whole second half, but to an extent, later in 3Q, maybe that gets better. Or is it really more of a 4Q phenomenon before you think absolute volumes start to increase?

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

Go ahead.

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

I'll say the first half of Q3 is going to be much -- very similar to Q2. And we think as Q3 progresses is when you're going to see your first opportunity for things to start to get better. Typically, Q4 is a little lighter than Q3. And so if you look at holiday downtime and some of the things that OEMs have done historically, we think there's going to be a lot of changes to that. And the OEMs are going to be more aggressive Tier 1s as well in terms of working through the fall and into the winter. And so we think there's upside, especially in Q4 to what's going on. Because historically, if you look at what's going on right now, right, I mean, on the consumer electronics side, you got a lot of bills happening right now to get ready for the holiday season. Once you get into Q4, there should be a lightning in demand on the consumer electronics side versus what's happening right now. And that will obviously would hopefully free up some capacity for automotive and other industries. But that's kind of our expectation is that Q3 is going to start basically like Q2. And then hopefully, it continues to get better throughout the end of the year.

Operator

Our next question comes from David Whiston with Morningstar.

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

I wanted to go back to a comment, Steve, that you made earlier in the Q&A that to me, implied that there has been some maybe inadequate communication from the OEMs to the suppliers. And I realize OEM supplier relationships are a bit of a soap opera, but how on earth is there still poor communication going on after so many decades of working together and how serious this chip issue is?

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

Well, I think it's less to do with intentional poor communication and more about what OEMs were planning to do this entire time, what they wanted to do and then not hearing -- I mean what happened really is during the quarter is a lot of our suppliers told us at the last minute or we found out when a shipment didn't arrive that we were short components or never shipped. And so a lot of suppliers we're dealing with the same problem, which is poor communication from the supply base. And then suddenly, you realize you have a problem, you're trying to find out, are you going to get the parts? Are you not? What kind of volumes? And then that information led upstream to the OEMs later than it should have. And then they had to make decisions with it, too.

So it's not that it was a deliberately poor communication. I would argue that it's actually gotten a lot better over the last few years, and it's gotten better during this. The issue is, is that on the supply side, especially on the silicon side, there's a lot of last-minute information coming in. There are a lot of short ship and no shipments that happened that obviously took a few weeks. And then what happens is, obviously, once that information matriculates up to the top and OEM then has to make a decision and then that has to work its way back down. Problem is as they change what they wanted, now you have to like redesign your entire production process around what part number they want, when do they want it. And so I wouldn't blame this on the OEMs. I would really say it was kind of a bottom-up issue from the supply base that cause OEMs to struggle with these issues.

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

So the last minute changes are those coming from the OEM or from upstream for you?

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

Well, it started with the Tier 2, 3, 4 supply base, and that was really driven by still playing catch up from last year's shutdowns all over the world. If you look at the supply chain for an electronic component, it's a very complex, very drawn out process that goes through -- especially on the Microchip side, goes through multiple countries in a lot of areas. And so that caused a lot of problems. Each of these countries going on shutdowns at different times caused tremendous, and still dealing with them, causes a tremendous backlog in information and processing. And so that started really on the supply side, multiple levels below Tier 1s and then obviously has impacted everything above it. And that communication historically hasn't been as good as it necessarily should have been on a Tier 2, 3 or 4 basis. And I think that's where the Tier 1s ended up struggling and then obviously causing problems for the OEMs at the last minute.

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

So given what you just said, is that why in the press release, you don't say shipper semiconductor shortage and just say heart shortage?

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

Well, yes, because it's more than just that. I mean other things that affected us is OEMs were struggling with plastics at times, foam for seats. There's been multiple different commodities that have been affected by this. And ultimately, those didn't affect us directly in that we didn't have foam that we needed to put in a mirror. But what did happen is an OEM can't get the seats that they need or a certain component, whether it's plastics or leather, they're changing what they're going to build or not build it in that case. And so that causes an OEM to go down, meaning we're planning to build. We might have even built the component for them. And then at the last minute, they're like, you know what, don't ship it because we don't need it because we're not going to be able to build those vehicles right now. And so the reason why we talk about shortages in general is because we're aware of all those different commodities causing problems in the industry. It's not just electronics.

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

Okay. That makes sense. And then this is probably for Kevin, but there's a chance the Biden administration is going to raise U.S. federal tax rate. And I was just curious, roughly do you think that would be -- Gentex' rate, would it be like a one-for-one impact in terms of every 100 bps in the federal rate? Or would it be less?

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

Yes. No. I think that there's a lot of speculation about the FDII, or the FDII, which is the big benefit to the company. So if it's -- if the headline rate just goes from '21 to say 28%, then we would expect it to move linear. But if the rate goes up and the FDII goes away, then it's going to be -- it will be a bigger impact than that. So I think we're -- we continue to stay close to it. There's speculation back and forth if the FDII is going away or if there's a replacement for the FDII, but yes, it would -- if it's just the headline rate, we would expect it to move linear for now.

Operator

Our next question comes from Charlie Sloan with Oak Family Advisors.

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

And actually, a great quarter. I mean, you guys are amazing in terms of your ability to generate cash during this time. And as you look forward and the Board's tenor around your excitement and enthusiasm around FDM and your positioning in the industry, how does the Board look at ASRs or any kind of shareholder -- other shareholder purchases as sort of going forward?

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

Yes. I think -- well, I mean, that focus is very, very deliberate and very intentional in terms of providing shareholder return, as you can imagine. One of the things that we've looked at is this philosophy in the last couple of years of consistent share repurchases driven around and supported by our estimates of future growth and profitability that has given the Board the confidence to say we're going to be aggressive there, try to return basically 100% of free cash flow to shareholders in the form of dividends and share repurchases is absolutely our strategy and tension.

The one thing I do always abbreviate that with is by saying if there's great M&A opportunities at right valuations that are a good fit for the company, those will move up and take the precedents over those prior to. But in the absence of something that we feel very confident about creating shareholder value, we're very confident in our ability to continue to grow the business organically and be very hyper focused really on making sure we're returning capital to shareholders in those 2 forms.

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

Sure. And then as a management team, how do you look at the current price of the stock, knowing that you don't control it, you just control the fundamentals and investors control the stock price. But the Board via your, I think, what do you have? Do you have just over $0.5 billion in net rainy day funds?

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

Yes. Yes. So I'll speak for myself personally when I talk about the share price. But if you look at what's happened, I felt like right over -- back up 3, 4 months ago, the price in the $36, $37 range seems like a very fair given our trajectory. We look at opportunities like what's happened right now with the retrench in the stock price as an opportunity to get a little more aggressive than what we have been on share repurchases, because we think this is more industry-wide background and it's not long-term fundamental issues with the company. If you fast forward 18 months, 2 years, whatever that time period is, if the fundamentals don't change economically, then i.e., there's no recession, cost of borrowing remains low and consumer demand for autos and especially our products remains high, there's no reason why the next couple of years can't be a great growth opportunity and great profitability time for the company. And so then we think that $32 a share right now is probably undervalued.

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

Well, we would share that opinion. And you are in compliance with all your debt covenants, correct?

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

Yes.

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

Okay. Because you don't have any debt, right?

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

That's correct.

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

Okay. Okay. Good. And then second -- lastly, are you going to have an Analyst Day coming up, no? What's your status of that?

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

Josh and I have been working on that. We were planning one, but then obviously, with still travel restrictions...

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

[Season is] rapid, it's hard.

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

Well, and last time -- what we were talking about doing one, the next one we did, we were toying with the concept of doing it in New York again because it's been a couple of years since we've been able to do one in New York. So we'll -- Josh will reach out to you and let you know when we may firm up those plans. But we've been trying to be reasonable about, obviously, people getting here is difficult and then how do we make sure we're doing something at a time period that's appropriate.

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

Yes. We would always encourage everybody to take part in CES and join us on the show floor there. It's much more fun to actually see and test on our products than it is to hear us talking about.

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

And you don't have to wait for an Analyst Day. If you want to come visit West Michigan, anytime, you're welcome.

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

Right. I mean it's pure Michigan. I don't know why the East Coasters won't come out. That's what I was saying.

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

Exactly.

Operator

I'm showing no further questions in queue at this time. I'd like to turn the call back to Josh O'Berski for closing remarks.

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

Thank you, everyone, for the time and questions today. We appreciate your attention, and hope you have a good weekend.

Operator

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