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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*

CONFERENCE CALL PARTICIPANTS

Aileen Elizabeth Smith *BofA Merrill Lynch, Research Division - Analyst*

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

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

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

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

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

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

PRESENTATION

Operator

Hello, and welcome to Gentex Reports Second Quarter 2019 Financial Results. (Operator Instructions)

Now it's my pleasure to turn the call to 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 Second Quarter 2019 Earnings Release Conference Call. I'm Josh O'Berski, Gentex Director of Investor Relations, and I'm joined by Steve Downing, President and CEO; Kevin Nash, Vice President of Finance and CFO; and Neil Boehm, Vice President of Engineering and CTO.

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This conference call contains forward-looking information within the meaning of the Gentex safe harbor statement included in the Gentex Reports Second Quarter 2019 Financial Results press release from earlier this morning and as always, shown on the Gentex website. Your participation in this conference call implies consent to these terms.

Now I'll turn the call over to Steve Downing, who will give the second quarter of 2019 financial summary. Steve?

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

Thank you, Josh. For the second quarter of 2019, the company reported net sales of $468.7 million, which was an increase of 3% compared to net sales of $455 million in the second quarter of 2018. This growth was in contrast to global light vehicle production that declined approximately 8% in the second quarter of 2019 versus last year.

Once again, the second quarter was very difficult to predict revenue as evidenced by the fact that IHS Markit's forecast worsened by approximately 4% versus the beginning of quarter forecast. Overall, the second quarter market conditions were very similar to those of the first quarter of this year, both of which included large reductions in global light vehicle production versus the prior year. Despite the current vehicle production environment being down about 8% from the second quarter of 2018, we were able to outperform the underlying market by approximately 11%, which resulted in a net 3% revenue growth rate for the quarter.

For the first 6 months of 2019, global vehicle production levels have been off by approximately 7% versus prior year, but we have been able to maintain our growth targets for the year. In fact, based on the first 6 months of the year and our forecast for the second half, we are actually raising the bottom end of the forecast range and narrowing our full year revenue guidance to be between $1.87 billion and $1.9 billion. Based on our first half of 2019 performance and the current IHS Markit forecast for the second half of the year, we are poised to outperform global automotive markets by approximately 7% for the year.

For the second quarter of 2019, the gross margin was 37.7%, which was a significant increase when compared to a gross margin of 36.2% in the first quarter of 2019. On a quarter-over-quarter basis, the gross margin for the second quarter of 2019 declined slightly compared to a gross margin of 38% for the second quarter of 2018. The gross margin in the quarter was negatively impacted by approximately 60 basis points due to tariffs that were not in place during the second quarter last year.

Our sequential gross margin expansion in 2019 was due to positive product mix driven by increases in Full Display Mirror and domestic exterior mirror growth, better-than-expected purchasing cost reductions, cost discipline throughout the company and success in mitigating some of the escalating costs related to tariffs that have been impacting the company since July of 2018. In fact, if you remove the 60 basis points of margin erosion due to tariffs, our gross margin was up 30 basis points versus last year. Our ability to maintain gross margins in a difficult production environment is a testament to the hard work and cost focus of the entire team at Gentex.

Operating expenses during the quarter were up 5% to $48.6 million when compared to operating expenses of $46.1 million last year. We managed our operating costs carefully during the quarter but with a deliberate intention of continuing to invest in future growth. The primary driver of increases in operating expenses is funding the resources needed for the development and launch of already sold products, including additional auto-dimming mirrors, Full Display Mirrors, Integrated Toll Modules and our new aerospace program. In addition, we are deploying resources to expand the product portfolio in the areas of connected car, digital vision and large area dimmable devices, which we believe will provide the potential for long-term growth.

Income from operations for the second quarter of 2019 increased 1% to $127.9 million when compared to income from operations of $126.7 million last year. The increase in income from operations was primarily due to the higher revenue in the quarter but was partially offset by lower operating margins when compared to the same period last year.

During the second quarter of 2019, the company's effective tax rate was 16.4%, up from 15.5% during the second quarter of 2018, primarily driven by a decrease in discrete tax benefits related to stock-based compensation.

Net income for the second quarter of 2019 was relatively flat at $109 million compared to the second quarter last year.

Earnings per diluted share for the second quarter of 2019 increased 5% to $0.42 when compared to $0.40 for the second quarter of 2018 primarily as a result of a 6% reduction in diluted shares outstanding from share repurchases due to the continued execution of the company's previously disclosed capital allocation strategy.

During the second quarter of 2019, the company repurchased approximately 3.1 million shares of its common stock at an average price of $22.72 per share for a total of $69.9 million of share repurchases. In the first half of 2019, the company has repurchased approximately 7.8 million shares of its common stock at an average price of $21.30 per share for a total of approximately $166.1 million of share repurchases. As of June 30, 2019, the company has approximately 26 million shares remaining available for repurchase pursuant to the previously announced share repurchase plan. The company intends to continue to repurchase additional shares of its common stock in the future in support of the previously disclosed capital allocation strategy, but share repurchases may vary from time to time and will continue to take into account macroeconomic issues, market trends and other factors that the company deems appropriate.

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

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

Thank you, Steve. Auto-dimming mirror unit shipments increased 2% in the second quarter of 2019 when compared with the second quarter of 2018 primarily driven by a 7% increase in exterior auto-dimming mirror unit shipments, which was highlighted by a 39% increase in North American exterior auto-dimming mirror unit shipments.

Automotive net sales in the second quarter of 2019 increased 3% to $456.6 million compared with $444.2 million in the second quarter of 2018. The growth in automotive sales was driven primarily by strength in Full Display Mirror and exterior auto-dimming mirror unit shipments. These product growth areas helped to offset annual customer price reductions and product-specific revenue headwinds.

Other net sales in the second quarter of 2019 were $12.1 million, an increase of 13% compared to $10.8 million in the second quarter of 2018 on increased dimmable aircraft window shipments and increased shipments of certain fire protection products.

Now for a balance sheet update. The following items represent a comparison versus December 31, 2018, which are also included in today's press release. Cash and cash equivalents were $260.3 million compared to $217 million. The increase was primarily due to cash flow from operations, which was partially offset by share repurchases, dividend payments and capital expenditures.

Short-term investments were $190.6 million, up from $169.4 million, and long-term investments were $121.1 million compared to $138 million. Fluctuations in the 2 were driven by changes in fixed income investment maturities within the portfolio.

Accounts receivable increased $12.9 million to $226.4 million primarily due to the higher sales level compared to the fourth quarter of 2018 as well as the timing of sales within each of the quarters. Inventories as of June 30 declined slightly to $225.1 million. Accounts payable decreased slightly to $90 million, and other current liabilities increased $11.2 million to $87.5 million primarily as a result of increases in accrued taxes and accrued wages.

Now for some cash flow highlights. Cash flow from operations for the second quarter of 2019 was $137.4 million compared with $144.9 million during the second quarter of 2018. Year-to-date, 2019 cash flow from operations was $273.5 million compared with $292.4 million in 2018. The differences in each of the periods were primarily due to changes in working capital.

Capital expenditures for the second quarter of 2019 were $28.7 million compared with $25.6 million in the second quarter of 2018. The year-to-date 2019 capital expenditures were $45.5 million compared with $51.9 million in 2018. And depreciation and amortization for the second quarter of 2019 was $25.2 million compared with $27.9 million in the second quarter of 2018. And year-to-date, depreciation and amortization was $53.3 million compared with $55.9 million in 2018.

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 2019, there were 33 total launches of our interior and exterior auto-dimming mirrors and electronic features. Of the total launches, approximately 40% had advanced features. While the percentage of new launches within advanced feature was slightly lower than previous quarters, the reason for it offers some interesting insights.

During the second quarter, we launched 8 interior auto-dimming mirrors on 4 new nameplates for domestic China OEMs, and 1 new nameplate was launched for domestic India OEM. These nameplate launches represent further penetration of our core auto-dimming technology for emerging market applications.

In regards to our Full Display Mirror product, the company launched 4 additional nameplates during the second quarter of 2019, which means we are currently shipping on 30 vehicle nameplates for this exciting new product. For the second half of 2019, we are forecasting approximately 8 new vehicle nameplate launches of Full Display Mirror.

Our last update for today is in regards to our Integrated Toll Module product. Late in the first quarter this year, we began our first volume shipments to Audi for the e-tron vehicle. During the second quarter of 2019, the first consumers began registering their ITM systems online to activate the device and begin using the system for normal tolling use. We are watching and waiting for feedback from the consumers, dealers and the OEM to help other customers understand the use case and consumer acceptance of this product. While the volumes are relatively low on this vehicle, we are excited to have successfully launched a new, innovative connected car product that includes transactional capability. Over the next 18 months, we continue to expect further nameplate launches with our launch customer, Audi, as well as the initial launch of ITM at 2 additional OEMs.

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

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

Thanks, Neil. Based on the mid-July 2019 IHS Markit light vehicle production forecast for our primary regions of North America, Europe, Japan, Korea and China, current forecasted product mix and expense growth estimates and year-to-date actual performance, the company is updating guidance for the remainder of calendar year 2019 in each of the following areas: revenue of $1.87 billion to $1.9 billion for the year; gross margins in the range of 36.5% to 37.5% for the year, which represents a 50 basis point improvement in the gross margin forecast for the year and includes estimates for the additional tariffs that became effective in June of 2019; operating expenses between $195 million and $200 million; estimated tax rate between 16% and 17%; capital expenditures between $90 million and $100 million; and depreciation and amortization between $100 million and $110 million. Additionally, the company is maintaining its previously announced revenue guidance for calendar year 2020 to be between 3% and 8% above 2019 revenue estimates.

The second quarter of 2019 was a challenging vehicle production environment, but the company delivered growth that outperformed our underlying market by approximately 11%. While we were pleased to see the sequential improvement in sales growth rate versus the first quarter, the most impressive performance was evidenced by the strong gross margin during the second quarter, which improved 150 basis points versus last quarter. The focus and hard work from the entire team at Gentex, combined with our disciplined approach to capital allocation, led to a 5% increase in EPS for the quarter.

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

QUESTIONS AND ANSWERS

Operator

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

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

Congrats on the quarter. So just on the gross margin guidance coming up a little bit, just a little bit more detail what you're seeing. Is it around the full display rollout? Is it around some mix tailwinds that you see? Is it cost control? Just a little bit more detail on what's driving that.

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

Yes. Thanks, Chris. It's a combination of some of the things we laid out earlier in the year, a little bit better participation from our purchasing cost reductions that initially with our struggle. Our teams have done a great job of improving that. We've offset some of the tariffs earlier in the year and are able to mitigate some of that going into the back half. But yes, the mix is going very well right now. As the weakness in China is playing out, we've talked before about base level products into the China market. Actually, that's been a tailwind for us on the margin side. So we're seeing a lot of the stuff continue into the back half of the year.

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

Okay. Got it. And then on the new nameplates for Full Display Mirror, would you be able to give us any more information on who the customer was? Are they passenger vehicles versus trucks or SUVs? Anything else you can give us there?

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

Yes. Absolutely. There's 4 new nameplates specifically. There was the Cadillac CT 5 -- or XT 6. I apologize, XT 6. There's the GMC Silverado heavy -- or GMC and Silverado heavy duty. And then there was the Jaguar Land Rover...

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

Sport.

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

The Discovery Sport. So...

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

Okay. Got it. And then with that -- was the -- is there any difference in content of those versus camera and screen or both or one or the other?

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

On GM, it's -- we're display mirror only. And then on the Range Rover, we're system.

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

Camera and display.

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

Okay. Got it. Got it. So if you look at maybe from a regional perspective, how you're thinking about the back half of the year, we've heard other suppliers kind of really cautious on Europe and cautious on China. It seems like China is kind of building up a little bit more from a penetration standpoint versus a market risk perspective. But I guess could you just comment regionally how you're feeling for the back half of the year?

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

Yes. I think what -- like when we came into the Q2 -- or into Q1 call heading into Q2, we made some comments that we are a little more pessimistic than what the IHS data showed in Q2, and actually, our forecast played out almost entirely the way we had expected it to. We did make some manual adjustments to the IHS data, which actually served us pretty well, helped us plan a little better than we would have if we'd gone purely off of that data. We're taking the same approach in the back half of this year. So despite there, you see the Q3 numbers that we post in the press release, the IHS numbers, we're probably a little more pessimistic than what those show. So we're hopeful.

Obviously, the comps get a little better in the second half of the year because China -- the China market started to fall apart really in the whole second half last year. So the comps are a little easier, but we really don't think there's a recovery there fully in place yet either. So we'd expect probably closer at showing growth in a couple of regions like in Europe and North America in the back half of this year, but we'd probably look at those as more flattish-type markets than we would growth markets.

Operator

And our next question comes from David Leiker with Baird.

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

I should know this number, but just remind me, please. How many FDM customers do you have now?

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

We're shipping at 5 currently. We have -- we've announced that we have 9 total sourced, but we haven't released the last 4 yet because they're not in production.

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

Okay. Great. And then as -- a couple of things. So your growth above market, great number here in the quarter. What you're talking about, something a little bit less than that. Can you talk through that a little bit? You're 11% in the quarter, and you're talking about 7% going forward.

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

Oh, yes. I think that's really -- the gap you see is the actuals -- the actual outperformance of the market in the first half. The 7% is really representing kind of what we believe IHS numbers forecast in the second half are probably a little higher than what they'll actually be. So the difference between the 2 would be not completely, but part of that's going to be kind of the manual adjustment that we're making to our back half forecast.

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

I follow you. So if you look over the next, I don't know, say, 3 or 5 years, what do you think from what you noted that you can commit to or suggest that you could do in terms of revenue growth relative to a flat -- say the market is flat, what do you think you're able to grow at?

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

We believe -- yes, we believe -- really our long-term projection is like mid- to upper single-digit outperformance to market conditions. So if you look at it and said, call it, 5% to 8% or something in that range, I mean that's what we're really targeting right now is to outperform our market by those type of levels.

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

And then a similar comment here on margins. You've got some headwinds that you're doing a nice job of offsetting. You're running gross margins today that are a couple of points below what they had been historically. What's a longer-term target as it relates to gross margins?

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

Yes. We think somewhere in that kind of 36% to 37.5% range is kind of the realistic range. We talked about this a couple of years ago when the margins got into like the high 38s that we didn't believe those were sustainable margins. If you look at that margin level, there was a lot of things factoring into that, that helped. But what I would say is if you -- like we mentioned, if you took tariffs out of this, we shouldn't exist obviously a few years ago. You're talking about a 38.3% gross margin, which would be at the very high end, if not outside of what we would look at as kind of a realistic long-term target.

So really, if you look at the natural evolution in margins, remember, if you back up 7, 8 years ago, they were actually well below where we are now. They were in the kind of 33%, 34% range. And so we've improved those significantly over the last few years. We do think there is kind of a natural barrier. And really, what that's driven by is the products that Neil talked about. Some of the launches with base auto-dimming applications in emerging markets are going to be a natural barrier to margin growth, but they also help drive revenue opportunities and then longer term, market opportunities.

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

And then one last item. It sounds like you're doing -- you're pretty good on mitigating some of these tariff issues. What's the path of being able to mitigate all of that? Or is that just not reasonable?

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

I think some of it is not reasonable until we have a change in business structure potentially, and we're evaluating that all the time. At this point, it's about a 50-50 split between tariffs inbound from raw materials and then tariffs on the export of our materials into the China market. So we're evaluating that business model all the time, and we continue to hope that there's a trade deal that would happen that would help us keep most of our business close to home. But again, if it goes too long, then we recognize that there's embedded costs that we need to address.

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

But we've addressed a significant amount of the potential tariffs already, and we're continuing to work towards action plans to mitigate smaller portions of those as we move forward. Then the question will become structurally how much of that can you accomplish versus how much do you have to spend to achieve the savings. And so that's -- those are simple make-buy decisions that we make every day.

Operator

And our next question comes from Ryan Brinkman with JPMorgan.

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

I saw the earnings release made some mention of better progress in mitigating the impact of tariffs. Can you talk about what those actions were, whether they relate to sourcing components from countries other than China, some other factor? I think you previously discussed the possibility of potentially local assembly in China, mentioning that you've done some of that in the past, all the facility there may be even used as a warehouse, et cetera. To what extent do you expect to make additional progress mitigating tariff costs?

And then just lastly along these lines, should China trade detentions be resolved, what happens then? Are you able to -- or would you desire to revert to your past practices thereby eliminating all tariff-related costs? Or would you want to or need to continue with these alternative sourcing or other coping mechanisms, which would mean maybe some elevated costs relative to prior?

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

Thanks, Ryan. I'll try to start and I think Steve will finish, so it's a pretty long statement there. So most of the work, if not all of it, so far has been around -- the first priority was looking at our existing supply base and seeing if they had manufacturing capabilities outside of China. So that's been one leg of the process. The other process has been changing some suppliers to places -- new suppliers outside of China. The other one was -- is honestly our team's going to work to look at the country of origin of some of the material that we source, and we've had some rulings of stuff that was originally thought to be China that's now Taiwan or another Far East region. So -- but that's been a primary work so far, and I'll let Steve talk about kind of the longer-term strategy there.

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

Yes. So like Kevin mentioned, everything has been focused right now on supply base, low risk, low cost of entry to get these -- the components done really with little or no cost impact over what we were, say, a year ago in terms of the building material of these items. So that was the primary focus, which we've executed very well.

The next stage of that like we had mentioned on our prior calls is a little more difficult and cost impacts, both lasting or upfront capital. And so what we're doing right now is evaluating those constantly. We have not started to do manufacturing in the China market for sales there yet. So we haven't made any permanent or lasting decisions in terms of the costs being able to mitigate. These are ones that are still before us. So we have plans right now we're working on, both to go further with additional suppliers to help mitigate tariffs and then also looking at alternatives for our own supplier products back into the China market, but none of those decisions are final yet.

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

Okay. Very helpful. This will be a much shorter question. What would you say are the primary factors that are allowing you to roughly maintain your full year revenue forecast at least at the midpoint in the face of some materially lower industry light vehicle production forecast? Is it primarily a penetration issue? Is it higher take rates? Or more traction on new launches, et cetera?

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

Yes. I mean if you look at the -- we kind of -- we try to -- probably not the greatest job, but we try to highlight a few of those in terms of growth into emerging markets with our base auto-dimming capabilities. Obviously, some of the takeover business that we talked about the last few quarters from our competitor on the outside mirror space has helped drive growth. And then the really strong interest in the launch of FDM has been one of the key drivers of the business in the first half of the year.

And so we continue to watch this. The one thing that's very interesting is we've been talking about the industry headwinds, but we've also had some of our own product headwinds with the Mobileye losses. And so as we're posting these growth rates, this is in the face of losses on the

Mobileye integration. So if you look at that now -- that back, we're really talking about even -- another 100 to 150 basis points better performance because of the headwinds that we're facing on the product side.

Operator

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

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

This is Aileen Smith on for John. First question, we've heard from a North American supplier earlier this quarter that there was an incremental pricing pressure and concessions that occurred intra-quarter and midyear, which is a bit abnormal. And you guys have talked about at length that the majority of the price down you faced hit in the first quarter, which you then worked to offset through the course of the year. Is there any indication that automakers are pushing for more now from you or from any other supplier? Or the pricing dynamics you face is pretty well known at this point and it's just a function of what you're able to offset in terms of purchasing cost reductions or other productivity initiatives?

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

Our experience is that the pricing pressure is relatively similar to what we faced the last few years. So I wouldn't say that anything's changed from an OEM standpoint. Obviously, with every supplier, there's unique situations that occur in your business with -- business relationship with the customer. So my guess is that some of it is related to that. Sometimes these things are a little more subjective than objective in terms of what this pricing pressure feel like. It doesn't vary from time to time, but I would say ours is relatively in line with our forecast and exactly with where we expected it to be at the beginning of the year.

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

Okay. Great. And second question, you referenced that part of the sequential margin expansion in the second quarter was a function of product -- of positive product mix with the Full Display Mirror. Correct me if I'm wrong, but I was under the impression that Full Display Mirror is more of a corporate average margin. So is the margin benefit really just attributable to exterior mirrors? Or are you now also seeing some margin uplift on FDM?

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

Well, it's really about that and the product mix. So you're not incorrect. The FDM is really in line with corporate average margins. However, when you're rolling off a Mobileye integration product, as that product is winding down and affecting our revenue growth rate, but it's actually being replaced with FDM products that are a better margin profile than the Mobileye integration product. So even though that represents a slight headwind to revenue because we're losing some business, it does improve profitability.

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

Great. That's very helpful. And last question, to follow up on one earlier around tariffs. As we think about the opportunity for some of the trade friction that exists right now to maybe be more structural in nature rather than what I think many seem to be transitory, and as you guys in particular work to expand further into international regions and emerging markets, do you have any updated thoughts around having -- whether having an international footprint with another plant in Europe or Asia would ultimately make sense?

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

Yes. We have actually a very large facility in Central Germany, and we have -- in the last 2 years have purchased a larger building in the Shanghai area. And that is always one that we're refurbing right now and getting ready. It's something that offers the potential. We distribute all the time out of our Shanghai facility for all the China market currently. And so if these things remain, the possibility for us to do localized final assembly in China is always on the table.

Aileen Elizabeth Smith - *BofA Merrill Lynch, Research Division - Analyst*

And how long would a transition like that to move it from a distribution center to a production facility take?

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

Well, right now what it is, is we're actually getting the purchase facility up to our current specs and how we like facilities designed and built. And so that should be done hopefully by the end of this year or early next year. And then from there, you're looking at probably another 12 months roughly when you can have final assembly going inside -- up and running inside of a facility.

Operator

And our next question comes from James Picariello with KeyBanc Capital Markets.

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

So you mentioned the driver is some SmartBeam headwind, I believe in the first quarter was roughly a 250 to 300 basis point headwind. What was it in the quarter? And what are your expectations now for the full year?

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

Yes. It was pretty much the same. I mean it's a combination of a weakness in our strong markets for the SmartBeam weakness. But when you put it all together, between 200 and 250 basis points of headwind in the quarter.

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

And then 200 still for the full year?

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

Yes, 200 to 250.

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

All right. And then regarding FDM, do you have any update on maybe what your annualized shipment target is? I know you've previously said greater than 500,000. Just curious if you got a cleaner update on that.

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

Yes. I think in the last quarter, one of the things -- last quarter conference call, one of the things we mentioned is that we felt very comfortable with -- we should be above that $0.5 million -- 0.5 million unit target for the full year. And that's being set, but we said well above.

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

So that's just unchanged.

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

Correct.

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

Is FDM included in your interior domestic unit number?

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

Wherever it's being shipped, it's included in the...

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

As a unit.

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

As a unit, yes.

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

Okay. Just last one, for exterior domestic, another quarter of very strong growth from a market share capture there. Just wondering what your thoughts are for the back half for that particular product.

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

It's going to start to revert to kind of normal growth rates in the back half of the year as we lap -- really if you think about -- yes, we're in the fourth quarter of...

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

Q3.

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

I think Q3 was the start of that takeover business last year.

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

And could that still be up year-over-year? Or would you expect that to...

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

Yes, it's a possibility. I mean depending on production obviously, what's winning in the market. But yes, it still shows outside mirrors in general or exterior mirrors in general are still growing above market.

Operator

(Operator Instructions) Our next question is from David Kelley with Jefferies.

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

Another one from FDM on me. Could you update us on the customer pipeline? I think you were targeting a 10th customer announcement by next quarter, but any update on new customer traction would be appreciated.

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

I think the customer side of it has gone extremely well. We don't have a 10th one to announce this quarter. We still do expect that in the third quarter, and we have some positive engagement with some additional customers as well.

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

The nice part is as we begin to ship these on more and more vehicles, more consumers are getting acclimated to the product and then obviously OEMs are getting to experience a noncompetitive vehicle. And so we believe that can help drive interest in the product longer term.

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

Okay. Great. And you maintain full year operating expense guidance. You've obviously got some fair amount of new product ramp and several new products in development. Could you just talk about the balances of managing the OpEx line while also investing in several of these growth portfolios?

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

Absolutely. In fact, that's probably the most challenging part of our job quite frankly is it's a difficult production environment. Obviously, we have a strong income statement, but making sure that we operate with discipline and we fund those ideas appropriately is probably the hardest part of the job in terms of finding that right balance. We believe like what we've seen in the first half of this year is probably the best execution we've had in that area in a while. It is growing slightly faster than our top line, but we believe we're funding those new development in technologies appropriately. Obviously, that could subject to change, and that's a very innovative company. When new ideas come up, we don't idle them purely based on the budget. We look at the ideas and almost with like a venture capital-type model of. If there's an amazing idea that's outside of our budget for the year but we'd see the long-term growth prospects, we're willing to step that up to make sure we're funding the appropriate innovations.

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

Okay. Got it. And last one for me and I'll pass it along. And I really appreciate the color on the China and India launches. I guess how quickly do you think your emerging market exposure can ramp in the next couple of years? Do you have either a shipment or maybe an annual sales growth target that you could share?

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

Well, I think really what we look at there is not in terms of unit. It's really looking at outperformance to market there as well. So we want our growth rate in emerging markets to be kind of at the higher end of our growth rate range for the company. And now it's difficult to do because in emerging markets, you're shipping lower-cost products or introductory base auto-dimming-type technology. But we believe there's absolutely an avenue for us to continue to grow in those emerging markets at the high end of the corporate growth rate range.

Operator

And our next question is from David Whiston with Morningstar.

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

First, going back to tariffs, a 2-part question. Given the guidance range, and I assume your German, Japanese customers are not that worried about new auto tariffs under Section 232, can you just talk about the sentiment or any chatter you're hearing from the German OEMs and the Japanese ones? That would be helpful. And then, Kevin, you talked about if these tariffs were to be enacted later this year, there are more costs you can address. So why not go ahead and make those cost reduction actions now anyway regardless if it's depressed?

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

Well, I think the -- some of the stuff has been enacted in June, List 3 going to 25%. Our teams have not stopped looking for ways to optimize that going forward. I think the one that I mentioned is there is also a retaliatory tariff that started in June going into China. And what I was referring to is changing the manufacturing process like Steve already had mentioned. That's a longer-term play. And if we do nothing, then that cost stays in the pipeline until we do change kind of our -- if we were to do final assembly in China, for instance. So that's the piece of why it's there and not addressed.

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

Well, and the reason why we're careful about that one is because we believe we have the right cost optimization model currently if there were no tariffs or if it was back the way it was, say, a year ago from a trade standpoint. And so we don't want to necessarily add those costs or the capital infusion in order to acquire or to get there to offset something that may not be a permanent part of our future. So we're just carefully watching that. We're actually building our plans around both models just in case. We'll continue to refine those. And if it looks like it's destined to stay, then we'll have to consider at least making different decisions, which we'll have multiple plans in place to address if that time comes.

As it relates to the sentiment from OEMs, what I would say is all the OEMs are obviously very aware. All of them take a different stance. One thing that is consistent is most OEMs ask us kind of, okay, what's your -- what would be the mitigation plan and how do we work through that together to make sure if something like this were to happen, to make sure that we could continue to do business in a cost-effective way. So a lot of this is all happening on the China front. We actually have requests from OEMs all over the world talking about their specific situation. And we discuss quite openly what our plans would be and what our capabilities would be to help support them.

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

Okay. That's helpful. And then moving on to the language in the press release on moving to large area dimmable devices. Are you talking outside of autos? Are you talking more like parts of the vehicle interior and windows? And related that, how do you avoid competing with many other firms in that space? I know it's something you try to avoid.

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

Yes. Well, the interesting part is if you look at our core electrochromic technology, there's not a long list of natural competitors for that type of technology. So we're not trying to compete with people that are doing commercial glass or automotive glass for that matter that is fixed transparency. We're looking at basically helping creating new version of a technology in the new space.

So our primary focus right now has been the aerospace market, that expansion and adding the 777 and that launch that we're working on currently. But then it's also looking at multiple use cases for dimmable glass or dimmable surfaces in a vehicle environment. Last year at CES, we showed that with multiple use cases, everything from sensor shrouds to kind of visor applications to sunroofs. And as we move forward, we're going to continue to look at new ideas and ways where that type of technology could be useful for a car today or a car of the future.

Operator

And I would like to turn the call back to Josh O'Berski for any final remarks.

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

Thank you. Thank you, everyone, for your time this morning. As a reminder, our Analyst and Investor Day is coming up on August 21 and will be held at our headquarters in Zeeland, Michigan. If you or someone from your firm is interested in attending, please reach out to me at your convenience, and I'll send over more details about the event. With that said, this concludes our call. Thank you, and have a great weekend.

Operator

Thank you, ladies and gentlemen, for participating in today's program. You may all disconnect. Have a wonderful day.
