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GNTX - Q1 2017 Gentex Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gentex Reports First Quarter 2017 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host, Mr. Jordan Diekema, Director of Finance. Sir, you may begin.

Jordan Diekema

Good morning, and welcome to the Gentex Corporation First Quarter 2017 Earnings Release Conference Call. I am Jordan Diekema, Director of Finance, filling in for Josh O'Berski. And I'm joined by Steve Downing, Senior Vice President and Chief Financial Officer; Kevin Nash, Vice President and Chief Accounting Officer; and Neil Boehm, Vice President of Engineering.

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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 First Quarter 2017 Financial Results press release from earlier this morning, and is always shown on the Gentex website. Your participation in this conference call implies consent to these terms.

Now I will turn the call over to Steve Downing, who will give the first quarter 2017 financial summary.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Thank you, Jordan. For the first quarter of 2017, the company is pleased to report net sales of $453.5 million, which was an increase of 12% compared to net sales of $405.6 million in the first quarter of 2016. The sales growth was driven by a 12% quarter-over-quarter increase in auto-dimming mirror unit shipments, while overall automotive light vehicle production in the company's primary regions increased by approximately 3% for the first quarter of 2017 when compared with the same quarter in 2016.

The gross profit margin in the first quarter of 2017 was 38.8% compared with a gross profit margin of 39.1% in the first quarter of 2016. The quarter-over-quarter net decrease in the gross profit margin was the result of annual customer price reductions, which was partially offset by purchasing cost reductions and favorable product mix.

Operating income for the first quarter of 2017 increased 11% to $134.4 million when compared to operating income of $120.8 million for the first quarter of 2016. Other income increased to $0.4 million in the first quarter of 2017 compared with a loss of $1.3 million in the first quarter of 2016, primarily due to an increase in investment income and realized gains on the sale of equity investments during the most recently completed quarter, as compared to the same quarter last year.

Net income for the first quarter of 2017 increased 22% to $97.6 million compared with net income of $80.3 million in the first quarter of 2016, driven by the 12% revenue growth as well as favorable discrete items that impacted the company's tax provision in the amount of $5.6 million. The favorable discrete tax items included $3.8 million related to a change in tax method, and $1.8 million related to newly adopted accounting guidance, which impacted the treatment of share-based compensation.

Earnings per diluted share in the first quarter of 2017 increased 18% to $0.33 compared with earnings per diluted share of $0.28 in the first quarter of 2016. The increase was primarily driven by the increase in net income on a quarter-over-quarter basis.

During the first quarter of 2017, the company repurchased 1.5 million shares of its common stock at an average price of $21.01 per share. As of March 31, 2017, the company has approximately 5.3 million shares remaining available for repurchase, pursuant to its previously announced share repurchase plan. The company intends to continue to repurchase additional shares of its common stock in the future, depending on macroeconomic issues, market trends, and other factors that the company deems appropriate.

During the first quarter of 2017, the company paid down $40 million on its revolver loan, in addition to its normally scheduled principle repayment on the company's term loan, which in combination was $41.9 million in debt repayment during the quarter. The company intends to continue to pay additional principle towards its loans in the future, depending on macroeconomic trends, capital expenditure spending, cash and money market interest rate, the amount of available free cash and other factors that it deems appropriate for timing and amounts of incremental debt repayments.

I will now turn the call over to Kevin Nash with the first quarter 2017 financial details.

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Thank you, Steve. Automotive net sales in the first quarter of 2017 were $445.6 million, an increase of 13% compared with automotive net sales of $394 million in the first quarter of 2016, driven by a 12% increase in auto-dimming mirror unit shipments on a quarter-over-quarter basis. Other net sales in the first quarter, which included dimmable aircraft windows and fire protection products, were $7.9 million compared to other sales of $11.6 million in the first quarter of 2016.

Operating expenses increased by 9% during the first quarter of 2017 to $41.4 million, due to staffing, increased travel and overseas office expenses. The company continues to estimate that its operating expenses will be between $165 million and $172 million for calendar year 2017.

As Steve mentioned, the tax rate during the first quarter of 2017 was 27.7%, which varied from the statutory rate of 35% due to the domestic manufacturing deduction as well as the favorable discrete items mentioned earlier. Excluding future impacts of the standard mentioned, the company continues to expect its tax rate to be approximately 31.5% to 32.5% for calendar year 2017. However, the new standard will cause variability in the company's effective tax rate going forward, depending on employee stock option exercise activity and the common stock price.

Now for some balance sheet items. The following balance sheet items represent a comparison versus December 31, 2016, which is also included in today's press release.

Cash and cash equivalents were $559.6 million, an increase of $13.2 million from $546.5 million, primarily due to cash flow from operations, net of accelerated debt repayments, capital expenditures, dividends and share repurchases. Accounts receivable was $249.5 million, up from $211.6 million, primarily due to the higher sales level as well as timing of sales within each of the periods. Inventories were $197.1 million, up from $189.3 million, primarily due to increases in raw materials. Short-term investments were $176.6 million compared to $177 million and long-term investments were $61.5 million, up from $49.9 million. Accounts payable was $77.7 million, a decrease from $80 million, primarily due to the timing of payments within each of the periods. Accrued liabilities were $196.6 million, up from $69.9 million primarily due to a reclassification of $100 million of long-term debt to short-term debt.

Cash flow highlights. Cash flow from operations for the first quarter of 2017 decreased to $131.2 million from $151.9 million in the first quarter of 2016 due to increases in net income that were more than offset by changes in working capital. Capital expenditures for the first quarter were $27.1 million compared with $20.3 million in the first quarter of 2016. And based on estimated completion dates for the company's current and planned capital expenditure projects, the company is maintaining its capital expenditure guidance range in the $115 million to $130 million range for calendar year 2017. Depreciation and amortization expense for the first quarter was $25.2 million compared to the first quarter of 2016 of $22.8 million. The company continues to estimate that depreciation and amortization expense for the calendar year will be between $95 million and $105 million.

And I will now hand over the call to Neil Boehm for a product and technology update.

Neil Boehm - *Gentex Corporation - VP of Engineering*

Thank you, Kevin. To begin, we would like to provide an update on our Full Display Mirror launches. As we've discussed previously, General Motors was our launch customer for this brand new technology. And through the fourth quarter of 2016, our Full Display Mirror product was available on 6 different nameplates in the GM lineup. Recently, GM began showing the all-new 2018 Chevy Traverse on its website, which includes our Full Display Mirror, or as GM calls it, the rear camera mirror, as one of the primary features identified on the vehicle. This will be the 7th vehicle in the GM lineup to include our Full Display Mirror.

Also, during the first quarter of 2017, we began shipping production of Full Display Mirrors to our second OEM. As we discussed previously, Gentex will be the system supplier for our second OEM launch, which means that Gentex's content for this program includes the rearward-facing camera, in addition to the Full Display Mirror. The details of this customer should be available on late second quarter once the customer begins their announcements or public marketing of the all-new technology.

The Gentex Full Display Mirror continues to gain strong interest from our customers for this vision-enhancing technology, and we remain excited about the future opportunities.

On the launch side, the company has continued to demonstrate solid growth, not only for our inside and outside electrical mirrors, but also for advanced technology products that are often housed inside of those mirrors. For the first quarter of 2017, the company experienced 11 net new nameplate launches of inside and outside mirrors. This first quarter launch rate is consistent with the launch rate in the first quarter of 2016, which was a record launch year for the company. These new launches consisted of approximately 50% advanced features. Although this is lower than the mix experienced most of last year, it is consistent with the percentage of advanced features in prior years.

Gentex continues to see strong launch rates for featured and base products of both inside and outside mirrors, which continues to be a leading indicator of our overall interest from our customers and our products.

I'll now hand the call back over to Steve for 2017 guidance and closing remarks.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Thank you, Neil. Based on the April 2017 IHS light vehicle production forecast and our current forecasted product mix and expense growth estimates, the company is making no changes to its 2017 revenue estimates of $1.78 billion to $1.85 billion and gross margins between 39% and 40%. However, based on weakening light vehicle production estimates in Europe for the second quarter and in North America in the third quarter, the company expects its revenue estimates for the second and third quarter of 2017 to be at or around the lower end of this annual guidance range but expects the fourth quarter to return to the higher end of its annual guidance range. Based on the current production data from IHS, our 2018 revenue estimates also remain unchanged from previous guidance.

We'd like to take a few minutes just to thank all of our employees of Gentex globally for their hard work and dedication that resulted in our first quarter results, especially given the supplier issues we have been working through since the fourth quarter of 2016.

We appreciate everyone's time today and we can now proceed to questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Chris Van Horn from FBR.

Christopher Ralph Van Horn - *FBR Capital Markets & Co., Research Division - Associate*

So on the Chevy Traverse, just -- could you walk us through kind of how that came about, and then what the penetration is going to be for that program? Is it going to be all platforms or just certain platforms to start?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, so on the penetration side, as has been pretty common with the FDM rollout at GM, it's going to be limited to some trim levels. Actually, on the Traverse, they haven't disclosed what those trim levels are yet. And so we're still waiting for GM to take the lead there and kind of walk through and show on their website what the packaging will look like for the product on the vehicle. In terms of, I think, the second part of your question was about how that came to be in terms of adding that vehicle, and really, this is kind of what we've been talking about for a little bit as it relates to GM's product strategy when they went down this path with us in developing this technology. It was really focused on kind of a broader execution. We had mentioned early on that we didn't think it would be limited to just the Cadillac lineup. Obviously, the Bolt was kind of the first indication of that. But then also now, adding the Traverse, we believe is a positive sign of GM's dedication to the product and how they're using it as one of their vehicle enhancements.

Christopher Ralph Van Horn - *FBR Capital Markets & Co., Research Division - Associate*

Got it, great. And then on the margin side, obviously, every first quarter, price reductions come through. Did you -- did anything stand out at you in terms of was it 1 program, 1 customer? Was it generally just across the board? And how did this kind of relate on a relative basis?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes. So you're right, Chris. Typically, the first quarter is the toughest one because we have our January 1 price downs. We don't get full benefit from our supply side cost downs there. But nothing outside of the normal, other than we had really strong mix in the fourth quarter because of product mix and then some of that shifted back to more base mirrors in the first quarter, so you saw a little bit of a headwind from that. But it should normalize kind of going forward from that supplier issue we saw in the fourth quarter.

Neil Boehm - *Gentex Corporation - VP of Engineering*

And we should -- that supplier issue did cause some of the mix issues fourth quarter to be higher than normal, and then first quarter to be slightly lower than -- slightly lower than normal.

Christopher Ralph Van Horn - *FBR Capital Markets & Co., Research Division - Associate*

Got it. And then just last one for me. Obviously, really strong showing at CES. This is the first time we've kind of talked to you since then. Could you update us on the pipeline for some of those new technologies you introduced? Because I think there's some interesting things there.

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Yes. So I think if you look at the -- thanks for bringing that up too. It was a strong show for us at CES in terms of new product offering. The thing we're busy right now is we would kind of put this in a time period of probably 18 to 24 months before we have anything probably to announce from those just because the products were pretty cutting edge and it does take a while to get the customer interest in there, their understanding of those products and then try to find a way to make them fit into their strategic lineup. But we have a lot of -- we've had a lot of meetings since then with OEMs going into deeper dive on what the aspects are of the products and then doing customer drive, letting them experience those products, especially we talked about the camera monitoring system. That's something that we worked hard on, and put together some development vehicles that have been positioned in various parts of the world, so that OEMs can get behind the wheel and experience what that product is like to drive. What I can tell you is that it's changed some of our relationships with our customers. We're getting higher level meetings and we're having a lot more interest around those products than what we have had historically.

Operator

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

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

I just want to follow up on that last question regarding 18, 24 months. Steve is that 18 to 24 months before you think you'd sign a contract? Or 18 to 24 months before it would go in -- any of those technologies would go into production?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Contracts, yes. So what we're -- yes, what we'd be focused on there is the sales and then the decision by the OEM, and then, obviously, going through the quote phase.

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

So then from a production commercial standpoint, it'd probably be another 12, 24 months after that?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, that's a fair time line. Probably more on the 24 side, especially when you start talking about CMS, I mean, that's probably even a hair longer because of the complexity of that product offering.

Neil Boehm - *Gentex Corporation - VP of Engineering*

Yes, the impact of styling a new vehicle.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Right.

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

Right. Okay, and then the launch on FDM with the second OE, is that confined to 1 or 2 platforms? Is that more broad-based?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

The initial launch for this one was a single platform. Obviously, with each of these OEMs we're announcing, we're expecting additional platforms over the next 12 to 24 months as they start to roll out the product.

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

Okay. And then are you done with the decontenting that occurred last year with one of your European-based customers? Is that fully lapped at this point?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, I would say the bulk of it was last year. I mean, you have a little bit of the vehicles that are rolling off, but 60%, 70% of that, in fact, was really last year.

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

Okay, okay. And then last one, I know I asked this question or someone asks it every quarter. But cash building, you've indicated a greater willingness to do M&A. How should we think about it? Are you more likely to do a larger transaction, if you will, around actually buying an entity for a few hundred million dollars? Or you're partnering with some other folks around some of these newer technologies? Is that maybe more the route you take around trying to diversify the business and sustain the growth rate?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Well, the simple answer is, we're obviously open to all of those. And so we're not opposed to the concept of looking at an acquisition that includes an income statement and a product offering, existing product offering. Really, over the last 2 years, what we've been focused on is more on the technology side. And that's kind of what you saw at the CES booth. It's more about taking the cutting edge technology, helping us incorporate that and develop the come to market strategy with that new tech. That -- but neither of those preclude the other. So I would say we're open to both. Obviously, it's a very active market on the M&A front. So we've been investigating a lot of things for better or for worse. We have to be able to find a deal that was -- we were able to close or at a price point that we felt was acceptable.

Operator

And our next question comes from the line of Brett Hoselton from KeyBanc.

Brett David Hoselton - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

First, just a follow on the Full Display Mirror product. Can you talk about what your thoughts are as far as future contract wins? In other words, as you look out over the next year, do you think that you'd be able to get another one, 2 customers on that? Or do you think that's optimistic? Or do you think you might be able to get more? I know you're -- I'm not asking you to name the customers, of course. But what's your general sense there?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, if you used -- I think you used the 1 year time line. Is that correct, Brett?

Brett David Hoselton - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Yes.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, if you looked out on the year, I think it's reasonable to expect we get at least one more during that time period.

Neil Boehm - *Gentex Corporation - VP of Engineering*

Yes, one additional.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

One additional contract. In other words, so -- with an OEM. And so we would use that as a reasonable expectation. It could be better than that, obviously. But I think that's a pretty safe and reasonable expectation.

Brett David Hoselton - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Okay. And then switching gears, HomeLink, you talked about potential growth in China. Can you give us a sense as to where is that at?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes. So like we mentioned before, it's just getting legs under it now.

Neil Boehm - *Gentex Corporation - VP of Engineering*

Right.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

I believe, in the next probably -- by the end of calendar year '17, we'll probably be shipping about 6 or 7 different nameplates, fairly low volume applications, but nonetheless, it's the beginning of that marketing process of introducing that product, and then walking the customer through the experience and making sure that the use case is met and that we execute flawlessly with the product launch.

Brett David Hoselton - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

And then finally, on the SmartBeam side, have you -- do you continue to get contract wins, I'd say, over the past 6 months or year, something along those lines?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes. We've continued to have contract wins on the SmartBeam product. The one thing that we have talked about is that there's wins and losses, obviously. The losses are predicated primarily on competition with full Driver Assist systems. And typically, our wins are coming in different type vehicles, either the lower end of vehicles or on lower segment vehicles or in emerging markets. And that's kind of been the trend, and we expect that trend to kind of continue. In other words, as full Driver Assist systems take off and start to become higher volume, it does create a bit of a headwind for the business. And we're looking for new ways to try to offset those losses in those lower segments or in those emerging markets.

Brett David Hoselton - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

So net-net, the SmartBeam revenue is probably going to be flat to down to some amount. Is that a fair statement?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes. I'd say, over the next few years, that's probably an accurate trend.

Brett David Hoselton - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Okay. And then, finally, did you quantify the -- you obviously had some commodity issues here in the fourth quarter. And did you quantify the revenue benefit from the reversal of those, as you moved into the first quarter?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

It was about $3 million -- we were about $3 million short in the fourth quarter from what we had not shipped, and then we kind of filled up back with that $3 million to $4 million of revenue. So not a major impact on the growth in the quarter, but that was...

Steven R. Downing - *Gentex Corporation - CFO and SVP*

But it did -- we did pick it back up, yes.

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Yes.

Operator

And our next question comes from the line of David Leiker from Baird.

Adam Christopher Schmitz - *Robert W. Baird & Co. Incorporated, Research Division - Research Analyst*

This is Adam on the line for David. Starting with the strength in international shipments. Certainly, Europe vehicle production was a positive in the quarter, but you and your growth above market was stronger than it has been in recent quarters. Any launches or regions you can point to driving the upside?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

No. I mean, if you look at it, especially in that European market, we've, like you mentioned, we had pretty good years over the last 5 years. I mean, really, if you'd take out last year and you look beyond that, our growth rates there were pretty strong. Last year, we've kind of settled back a little. But then this year is kind of picking back up again. If you look at it, it's really across the board. A lot of that's driven by some of our frameless technology. There's been a lot of inside mirrors. Obviously, we've done fairly well on outside mirrors in that marketplace too over the last 5 years. So I'd say it's pretty well distributed across the board and across all OEMs.

Adam Christopher Schmitz - *Robert W. Baird & Co. Incorporated, Research Division - Research Analyst*

Great. And then turning to the camera monitoring system that you debuted at CES, now that you've had some time to talk to customers, what has been the feedback on this product? And then for those customers, what vehicle segments are they looking to launch this product in?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, so I'd say first what their reaction is, and then we'll kind of get into what their -- how OEMs make decisions. So when you look at their reaction, I think, especially when they drive it, so when we get vehicles in their local area where they can drive and experience the car, their immediate reaction is kind of how, what we expected it to be and why we came up with this product offering, and that is they knew the limitations of camera and display-only technologies. And that's what really had slowed down that evolution, is that it doesn't meet all the use cases. So when we show this car, it's kind of taken the best of both worlds, combining them into a single product and they see the practical application and why that may be a logical step. Now as it relates to how that influences their decision-making, that's a long process. I mean, you talk about OEMs, very large organizations. And a very critical part of the vehicle and safety of that vehicle are mirrors and displays. So it takes time, and that's the big thing that we found is we have to distribute this product very widely inside of an OEM in order to get a positive decision or to get a sourcing commitment. So we think that's still going to take quite a while, like we talked about, in that kind of year to 2 year decision-making window before we'll see any positive trends from that product offering.

Operator

And our next question comes from the line of Jason Rodgers from Great Lakes Review.

Jason Andrew Rodgers - *Great Lakes Review - VP*

I wonder if you could expand a little bit more about your -- the comments made on SmartBeam as far as revenues expect to be -- I think you said flat to slightly down, was the comment, over the next few years. Why that's the case, and that 6% to 10% revenue forecast for this year and next year, I guess, that would assume no growth from SmartBeam?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, exactly. So when we give the annual guidance for '17 and '18, those are net of those type of trends inside of any one of the products. So that's not -- that doesn't take away from that growth rate projection. And really, what's driving that is just the acceptance and the wider penetration of full Driver Assist systems in the vehicle space. So in other words, when there's already a camera on the car that's doing the lane departure warning or forward crash, obviously, they don't necessarily need to have a second camera to do lighting control. And so from an economic standpoint, the OEMs are looking for the cheapest way to accomplish that feature set, and often times, it's going to be more advantageous for them to add that type of content and software to an existing hardware module, and so that's what's causing most of the headwind. Now what we've been successful at over the last few years, and this has been the case for, really, the last 5, 6 years since Driver Assist has started to roll out in higher volumes. What we've always been able to do is find lower segments, like in other words, an A, B or C segment play or the lower term levels on an existing vehicle, in other words, the entry-level vehicle may have a lighting only and an upgrade to Driver Assist, higher trim levels and then the third area we've been able to find success is in emerging markets. So lower cost car markets, where full Driver Assist system hasn't taken off or isn't as widely accepted. And so that's what's caused kind of that flattish to slightly down play on the SmartBeam product. But we've been able to more than offset that with growth rates in our other product offerings.

Jason Andrew Rodgers - *Great Lakes Review - VP*

So long-term, high single digit or so growth for the company can be achieved through HomeLink in the Full Display Mirror? You don't necessarily need SmartBeam to grow. Is that a fair statement?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, exactly. I mean, we're not -- one of the nice things and one of things you've seen the company kind of really work hard at over the last few years is expand that product offering. So we're not as dependent on any one product in order to get to above market growth rates.

Jason Andrew Rodgers - *Great Lakes Review - VP*

All right. And just looking at the updated guidance based on the forecast for automotive production, would it be fair to say the second quarter will be more difficult than the third, just given the drop in Europe that's anticipated? And is it possible that your revenue could drop below the 6% for the second quarter? Or do you still think it will fall in that range?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Well, I'd say, first, I don't think there'll be much of a difference in second and third in terms of the headwind from production. Because if you look at -- Europe's basically going to be down about 5% year-over-year in the second, and North America is going to be down about 5% in the third year-over-year. So we look at those. And when we kind of extrapolate our take rates on those production volumes, we look at it and say, it's about an equal amount of headwind for us in between those 2 quarters. It's theoretically possible always that you can drop below your guidance. I mean, depending on what actually happens versus what's forecasted to happen. But right now, when we look at the guidance for second and third quarters, I mean, we're still inside of our annual guidance range, and we feel comfortable with that. We don't see or feel anything happening in the marketplace that would drive it to be below that, and so we feel pretty comfortable with how we're positioned. But obviously, we'd never say that it's not possible to drop outside of our guidance range.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And just 2 quick number questions, what percent of your current mirror shipments are frameless and what was the total debt balance at quarter end?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

So the frameless volumes, we'd have to get back with you on it. I don't want to just speculate exactly what that percentage of frameless was versus all inside mirrors. So if you would like, we could talk about that a little later. But I would say it's probably in that 15% to 20% range, I would guess, of total inside mirror shipments. But that's shooting from the hip. We'd want to check the data to get you a firm answer there. Yes, and the debt balance is $136 million as of quarter end.

Operator

And our next question comes from the line of Ryan Brinkman from JPMorgan.

Samik Chatterjee - *JP Morgan Chase & Co, Research Division - Analyst*

This is Samik on behalf of Ryan Brinkman. Firstly, I wanted to go back to the comment about gross margins. And I know within the first quarter, there's always the annual purchase price reduction effect we see the impact of. But when we look at the year-over-year, I wanted to clarify if there was an impact from raw material inflation on a year-over-year basis because we've seen commodities run up over the last few months. And also, if you can remind us what's your biggest spend in terms of raw material and how you're probably -- how do you tackle changes in prices in terms of how you hedge with your suppliers? Or do you have the ability to pass them on to your -- to the OEM customers?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Sure. So if you start first, if you look at the change year-over-year, basically what the net decrease was caused by was our customer -- our reductions to our customers and us not being able to fully offset those with our supplier cost reductions. So yes, you're absolutely right. That's the single biggest impact to the quarter, and what that's -- and that's caused by -- just as you mentioned, it is a tougher commodities market. Now we still feel comfortable that in Q1, especially, it's hard for us because with our inventory levels, you're still shipping most of the product that you ship in Q1 as still at prior-year purchases. So you have last year's economics on the cost side, and this year's economics on the pricing side. Now we believe that will improve throughout the year, as we roll through that inventory and get into 2017 cost basis of our materials. But the important part there is that, yes, it did fall behind this PPV or our purchase reductions did, was behind our pricing reductions to our customer, and that what's caused most of the margin pressure. Now as it relates to the tightening in the supply side, it is a tougher market in certain commodities, most of our purchases in electronics, which has shown a pretty good trend overall over the last several years and we've continued to believe there's opportunities on the electronics side. When you start talking plastics and metals and some of the others, those are primarily the commodities that are struggling, and have a little more pressure on them. And so we have to work through design elements, engineering tasks, and obviously, contracts with our customers -- with our suppliers to try to find ways to gain the efficiencies that we need.

Samik Chatterjee - *JP Morgan Chase & Co, Research Division - Analyst*

Got it. And just a quick follow up on that, is there ability to pass on these changes in the commodity prices or raw materials easier on platforms, where you are a standard versus where you are option?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

No, I'd say it's very difficult for us and this product and how we are -- how we position ourselves and our products to gain relief from the OEMs on cost pressures associated with the supply side. Like we mentioned before, this isn't really about -- this isn't abnormal for us, in other words, that you see little bit of pressure in Q1 on the margin as it relates to commodities pricing. It's just something that we tend to work through throughout the year and get better at as the year progresses.

Samik Chatterjee - *JP Morgan Chase & Co, Research Division - Analyst*

Got it. That's helpful. And just a final question, today, you've sort of spent some time highlighting the weaker production environment that you're seeing in Europe and also in North America. And it seems like that's somewhat softer environment that you're seeing from the -- here at the start of the year. So just curious, how do you think about sort of adoption or even customer appetite for your advanced feature products and the higher ASP products, given entertainment environment, where productions are weaker. How do you think about your option of those tracking?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Sure. Well, there's 2 elements and we like to -- and that's a good question because we like to spend a little time talking about. There's 2 distinct elements as it relates to auto production. One of them is the number of cars produced. And if you look across the segmentation, there's a lot of different economics associated with purchase decisions by consumers, anywhere from $15,000 cars to $150,000 cars, and so it's not just about how many cars are produced. It's about what is the average content or price of those cars when they're consumed. And what you tend to see is that, in this environment, for instance, we're not seeing as much pressure on the technology side or on the pricing of the vehicles as much as about the total volume. And so one of the things we're focused on, our OEMs are still interested in technology because they are differentiators for them. And it is what the consumer is interested in is seeing that technology advancement and deployment in the vehicle environment. So we continue to work really hard to show them alternatives and unique products that we hope will help separate their vehicles and create a technology package that the consumer values.

Operator

And our next question comes from the line of Matt Stover from SIG.

Matthew T. Stover - *Susquehanna Financial Group, LLLP, Research Division - Analyst*

Two things. One, just to clarify, if you could just comment on your expectations for production. Is that a reflection of the IHS numbers you're seeing? Or are you making additional subjective decisions or judgments about production schedules in particular regions and particular period of times?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

No. I mean, basically, when we -- yes, when we talk about that, that is a pure IHS number. So when we look at the downside in Europe and downside in North America, that was the end of March based on IHS forecast.

Matthew T. Stover - *Susquehanna Financial Group, LLLP, Research Division - Analyst*

Yes, yes, okay. And the second question is, is if we look at the Full Display Mirrors, how should we think about the margin impact of those products over the course of the next couple of years as their volume builds? Is that more favorable relative to the average, at the average or below?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

In terms of revenue or gross margin?

Matthew T. Stover - *Susquehanna Financial Group, LLLP, Research Division - Analyst*

I'm thinking gross margin.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

So well, okay, so we've talked about the revenue aspects, so the higher ASP, obviously, associated with those products. And we believe those -- the trend will be towards the corporate average.

Matthew T. Stover - *Susquehanna Financial Group, LLLP, Research Division - Analyst*

Towards the corporate average, okay.

Operator

Our next question comes from the line of David Whiston from MorningStar.

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

I wanted to first start with biometrics. Just thinking long term here. I mean, what areas of that could you do more beyond iris scans? I mean, could you something like a fingerprint in the mirror or voice recognition, things like that?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, I mean, if you look at the possibilities, there's a lot of things that we have a skill set in that we could bring to the market. Historically, we've shied away from anything that touches kind of the glass surface and the reason why is it's cosmetically not a great solution when it comes to fingerprints and leaving fingerprints on a reflective surface, it tends to look bad. It's not to say that you can't do it. I mean, technologically, it's feasible. The issue is trying to find what do our customers want. So what we're really focused on is how do we offer that kind of that security solution in a biometrics form with a very high level of security that fits the customers use case and what they want their customer experience to be. And so what's interesting about this with the iris offering is it's kind of taken us into different discussions with our customers that we haven't had historically to try to understand just that, what is their desire, what are they looking for, for their customer experience and is there a way for Gentex to play a part of that?

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

Okay. And international unit volume is growing much better than domestic or North America. And just particular, for this quarter, on the variance, I mean, where is most of this international growth coming from?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Yes, you typically are going to see that, David, because of our higher penetration in North America. And so we did see, like Steve talked about earlier, Europe was pretty strong in the quarter, but Japan and Korea actually performed very well for us. So the Korean customers have been kind of in a lull lately. But this quarter was a strong performance. And then Japan, we saw good growth there. So it was really, again, a function of, I think we've been talking about for a long time, Japan and Korea have been depressed. But they saw a little bit of a turnaround in the quarter.

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

Okay, and my last question is on your comments earlier on the production forecast. And I believe -- and Q4 is going to pick back up versus Q2, Q3 softness. I mean, what gives you confidence of that forecast by IHS will prove correct? Is it just the expectation on new model roll overs, product cadence?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Well, really, when you look at it, you're looking at year-over-year comps. And so the headwind from Europe and North America in Q2 and Q3 have a portion to do with this year in the production level but also the prior year's production level and how does that look. And so when we look at that forecast, we feel fairly comfortable. We feel fairly comfortable with what those are going to be. And typically, you have the seasonality of the calendar year as it relates to OEMs and their production levels. When we look at Q4, we don't see any of those numbers that look too far out of the norm versus what the OEMs are planning on. Now as it relates to Q2, we just have better color. I mean, you're typically dealing in 4 to 12 week release windows from your customers, and so where you start to get actual orders versus just IHS data, and that's what's gives us the confidence around Q2 and starting to move into Q3. Q4 is really just a pure forecast at that point. But the point is like what we study as a regression analysis around IHS and how they do from a forecast standpoint, 3, 6 and 9 months out. And we don't see anything that would -- that to us appears like it's challenged beyond the numbers they're forecasting.

Operator

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

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

Maybe if I could just kind of follow up on that question. Is there anything outside of the production schedule specifically around your business on product launches that's creating some sort of pressure in the second and third quarter that might bounce back in the fourth quarter, so you wouldn't be as reliant on these schedules bouncing back?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

No. If you look at -- I mean, if you look at our launch cadence and what's happening with the business, we don't see anything on our side that would be changing. In Q2 or Q3, that will then come back in Q4. You have normal roll off of old programs and a restart of some of them. You have the normal cadence inside of the automotive cycle. Obviously, IHS tends to be a hair bearish in Q3, especially on shutdowns. And so part of that may be driving the cut in production, especially in the North American market in Q3. But aside from that, we don't see anything on our side that would be changing that growth rate story inside the year.

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

Got it, okay. Then just a second question, and I apologize I don't think I've heard anything on HomeLink and sort of an update on take rates and the future of that business. I think you've talked about SmartBeam. But is there any update on HomeLink and take rates and how that business is going?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, I mean, if you look at it, since -- I'll kind of just back up, really. Since the acquisition, we've posted pretty solid numbers on the growth story as it relates to HomeLink. So typically, at about 10%, really, over the kind of 3, 3.5 year period. It's been running right around there, 10% slightly above at times. We continue to believe that, that kind of 6% to 10% growth rate that we've talked about corporately is right in line with what we expect HomeLink and what we've seen out of the HomeLink product in terms of penetration.

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

Okay, and then just lastly, the $100 million that went from long-term debt to short-term debt, I mean, as I look at that, as far as I can tell, a lot of maturities or all the maturities you have are September of 2018, so that's outside of 12 months. I'm just curious why that got reclassified into short-term debt?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

Yes, it's just more of being outward about our intent and what's going to become based on our payment schedules, what we plan to pay down over the next 12. And then obviously, like you said, once it becomes current, the rest of it will fold over into current at that time. So September, you should expect the full balance to become current after the third quarter.

Neil Boehm - *Gentex Corporation - VP of Engineering*

So it's a clear signal that a big $100 million chunk of it is going to get paid almost 6 months early, right? It's the simple way to put it?

Kevin C. Nash - *Gentex Corporation - CAO and VP of Accounting*

I mean, if you look, we've been averaging between $20 million and kind of $40 million a quarter, depending on cash flow from operations and how it's looking in preparation honestly, for that October '18 maturity of the debt.

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

So I guess there's no rash -- I mean, there's no thought process of potentially trying to roll this debt in the market? It seems like you guys are just heading towards the paydown path?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, exactly. And the reason why primarily it's a variable rate -- it's variable rate debt today. Obviously, there's speculation on what those rates are going to look like. We feel like we're in a better position to go ahead and pay that down. And then if an acquisition presents itself, obviously, we can always kind of reschedule or re-up a new borrowing tool to cover that new target. But based off of the operations of the business, our cash generation model, and where we're headed, it's definitely a sign that we're intending to pay that all off by the fall of '18.

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

And I'm sorry, to put a finer point on it, it means that you guys will let those facilities expire, won't re-up them unless you see some other kind of opportunity emerge over the next 12 months or in the couple of years, whatever, maybe...

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, I mean -- yes, that one is just a function of the cost of those instruments. And if they're very effective and inexpensive to have them available, we will. Obviously, we're not going to carry cost that we don't need if we don't see a target on the horizon that looks like we need availability of cash.

Operator

Our next question comes from the line of Jason Rodgers from Great Lakes Review.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Do you have the growth rate of SmartBeam revenue-wise in 2016?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

I'm sorry, could you say that again?

Jason Andrew Rodgers - *Great Lakes Review - VP*

The SmartBeam, the revenue growth rate for SmartBeam in 2016.

Steven R. Downing - *Gentex Corporation - CFO and SVP*

In '16, it was -- I think it was mid-single digits.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Okay. So just to be clear then, you're expecting that to be flattish or so going forward?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, flat to down, yes.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Okay. And as far as HomeLink, what is the churn penetration rate of HomeLink in the U.S.?

Steven R. Downing - *Gentex Corporation - CFO and SVP*

Yes, you're right around 50% right now.

Operator

I'm showing no further questions, and I would like to turn the call back over to Mr. Jordan Diekema for any further remarks.

Jordan Diekema

That's all from us, guys. Thank you.

Operator

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