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GNTX.OQ - Q2 2022 Gentex Corp Earnings Call

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OVERVIEW:

Co. reported 2Q22 net sales of $463.4m, net income of $72.4m and diluted EPS of $0.31. Expects calendar year 2023 revenue growth to be approx. 15-20%. Expects calendar year 2022 revenues to be $1.87-1.97b.

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

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

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

PRESENTATION

Operator

Good day, and welcome to Gentex Reports Second Quarter 2022 Financial Results Call. (Operator Instructions)

As a reminder, this call is being recorded.

I would now like to turn the call over to Josh O'Berski, Director of Investor Relations. You may begin.

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

Thank you. Good morning, and welcome to the Gentex Corporation's Second Quarter 2022 Earnings Release Conference Call. I'm Josh O'Berski, Gentex's Director of Investor Relations, and I'm joined by Steve Downing, President and CEO; Neil Boehm, Vice President of Engineering and CTO; and Kevin Nash, Vice President of Finance and CFO.

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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 2022 financial results press release from earlier this morning and as always shown on the Gentex website. Your participation in this conference call implies consent to these terms.

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

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

Thank you, Josh. For the second quarter of 2022, the company reported net sales of $463.4 million compared to net sales of $428 million in the second quarter of 2021, which was an 8% increase quarter-over-quarter. For the second quarter of 2022, global light vehicle production in North America, Europe, Japan, Korea and China decreased approximately 3% when compared to the second quarter of 2021. Light vehicle production in the company's primary markets of North America, Europe and Japan, Korea was down 1% on a quarter-over-quarter basis, primarily driven by vehicle production increases in North America that were more than offset by reductions in Europe, Japan and Korea. While we are pleased with our sales performance compared to the light vehicle production, which represents a 9% outperformance to our primary markets, an 11% outperformance to the global market, it is important to note that sales for the quarter fell short of our beginning of quarter forecast by approximately $70 million to $80 million.

The sales shortfall was primarily driven by the fact that the light vehicle production in our primary markets was 4% lower than forecasted at the beginning of the quarter and then was further compounded by component issues that negatively impacted mix on some of our advanced feature products. While there appears to be some improved stability in light vehicle production environment as compared to a year ago, the company is still experiencing significant customer order fluctuations on a week-to-week basis. The industry dynamics continue to create a difficult forecasting environment. However, we still believe that the continuing strong demand for light vehicles, combined with the historically low level of light vehicle inventories should create a better sales environment as we move throughout the rest of this year and into 2023.

For the second quarter of 2022, the gross margin was 32% compared to a gross margin of 35.4% for the second quarter of 2021. Gross margin was impacted on a quarter-over-quarter basis by raw material cost increases, labor cost increases, lower-than-expected sales levels and customer order volatility, logistics cost increases and product mix shifts. Inflationary pressures on our raw materials resulted in a margin impact of approximately 150 basis points. Higher labor costs impacted margins by approximately 60 basis points -- the lower-than-forecasted sales levels and customer order volatility resulted in approximately 150 basis points of margin headwind. Logistics costs impacted margins by approximately 50 basis points and product mix shifts resulted in approximately 60 basis points of headwind. The total of these issues mentioned created approximately 470 basis points of margin headwind, but we were able to offset some of these issues through lower than forecasted price downs to our customers and fixed and variable overhead efficiencies.

While we currently expect that many of these challenges will continue throughout 2022 and into 2023, we are optimistic about our ability to stabilize and offset many of these headwinds due to the progress we are making with our customers regarding the inflationary aspects of our business by building collaborative relationships that provide opportunities to minimize the impact of these inflationary pressures on our respective business models.

Operating expenses during the second quarter of 2022 increased by 21% to $62.6 million compared to operating expenses of $51.7 million in the second quarter of 2021. Operating expenses increased during the second quarter of 2022 due to staffing and professional fees, outbound freight expenses and travel-related expenses. Our operating expense growth rate for the second quarter of 2022 was significantly higher than our sales growth rate for the same quarter but was necessary to support previously sourced new program launches, product redesigns and support of component issues and our ongoing commitment to new technology areas.

Additionally, the higher levels of operating expenses are more than justified based on our current forecasted growth rate throughout 2022 and into 2023. Income from operations for the second quarter of 2022 was $85.8 million compared to income from operations of $99.9 million for the second quarter of 2021.

During the second quarter of 2022, the company had an effective tax rate of 14.6%, which is primarily driven by the benefit of the foreign-derived intangible income deduction and discrete benefits from stock-based compensation. Net income was $72.4 million for the second quarter of 2022 compared to net income of $86.5 million for the second quarter of 2021. The change in net income was primarily the result of the quarter-over-quarter changes in sales, gross margins and operating profits. Earnings per diluted share for the second quarter of 2022 were $0.31 compared to earnings per diluted share of $0.36 for the second quarter of 2021.

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*

Thanks, Steve. Automotive net sales in the second quarter of '22 were $452.9 million compared with $420.6 million, an 8% increase over the second quarter of 2021. And auto-dimming mirror unit shipments increased 3% during the quarter compared to the second quarter of '21. Other net sales in the second quarter of '22, which includes dimmable aircraft windows and fire protection products was $10.5 million compared to other net sales of $7.4 million in the second quarter of '21. Fire protection sales increased by 53% for the second quarter of '22 compared to the second quarter of '21. Dimmable aircraft window sales decreased by 22% for the second quarter compared to the second quarter of last year.

The company continues to expect that dimmable aircraft window sales will be negatively impacted until there is a more meaningful recovery of the aerospace industry and the Boeing 787 aircraft production levels improve. During the second quarter of '22, the company did not repurchase any shares of its common stock. And as of June 30, 2022, the company has approximately 22.4 million shares remaining available for repurchase pursuant to its previously announced share repurchase plan. The company intends to continue to repurchase additional shares of its common stock in the future in support of the previously disclosed capital allocation strategy, but share repurchases may vary from time to time and will take into account macroeconomic issues, including the impact of the COVID-19 pandemic and supply constraints, market trends and other factors the company deems appropriate.

Let's look at a few key balance sheet items. The balance sheet items mentioned today are values as of June 30, '22 and are compared to December 31, '21, unless otherwise noted. Cash and cash equivalents were $269.4 million, up $262.3 million, primarily due to cash flow from operations and investment sales, which were partially offset by share repurchases, dividend payments and capital expenditures. Short-term and long-term investments combined were $209.6 million, down from $213.1 million.

Accounts receivable was $274.4 million, up from $249.8 million due to the timing of sales within quarter inventories were $392.6 million, which increased from $316.3 million, primarily in raw materials. The company continues to take a proactive position related to raw materials and Tory with ongoing supply chain issues, component shortage issues in addition to customer order volatility, the company has taken on additional components of certain medium and long lead time items to help manage risk and meet customer demand, which has been changing quickly and constantly. As previously mentioned, when the supply chain constraints start to alleviate and the component shortages begin to decline, the company will evaluate the proper levels of inventory at each commodity level.

Accounts payable increased to $186.6 million, up from $98.3 million, primarily due to increased inventory purchases and capital expenditures. Quickly looking at the cash flow statement. The second quarter of 2022 cash flow from operations was $110.9 million compared with $62.4 million in the second quarter of '21. Operating cash flow was impacted by lower net income quarter-over-quarter but was more than offset by fluctuations in working capital. And year-to-date, cash flow from operations was $226.9 million compared to $252.2 million in operating cash flow for year-to-date '21.

CapEx for the second quarter was $34.1 million compared with $18.8 million for the second quarter of last year. And year-to-date, CapEx was $58 million compared to $31.3 million for year-to-date 2021 CapEx. And depreciation and amortization for the second quarter was $25.3 million compared with $25.9 million for the second quarter of '21. And lastly, year-to-date depreciation was $50 million compared with $51.5 million for calendar year '21.

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

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

Thank you, Kevin. The Gentex team was extremely busy during this last quarter as we experienced our highest Q2 launch rate of our inside and outside auto-dimming mirrors and electronic features since 2016. For the second quarter of 2022, we had 44 total new launches of our interior and exterior auto-dimming mirrors and electronic features with our base interior auto-dimming mirror, HomeLink and Full Display Mirror leading the way.

Over 40% of our net base interior auto-dimming mirror launches were for Chinese OEMs for the China domestic market. As I mentioned last quarter, continuing to expand the penetration of our base interior auto-dimming mirror is a critical part for us to continue to add and grow new feature content for future projects. Now for a quick Full Display Mirror update. We're happy to announce that during the second quarter of '22, we began shipping Full Display Mirrors for the Mercedes-AMG ONE and the Range Rover Sport. It's exciting to add these incredible vehicles to our long list of Full Display Mirror launches and they bring our total Full Display Mirror nameplates shipping up to 72. Over the second half of '22, we are expecting to see an additional 8 nameplates launch, and we're anticipating the ability to announce our 14th OEM.

The interest in Full Display Mirror continues to grow, and we're excited to see the expansion of this product over the coming years. The team at Gentex has done a phenomenal job in handling the high level of launches as well as the increased workload due to product redesigns caused by the current supply constraints of certain components. In fact, over the last year, we've had as much as 30% of our development team focused on product redesigns to avoid constrained components for our customer. As we look forward, we continue to see strong launch rates and product rollouts, which we believe will continue to position the company with the technology and product portfolio that will drive growth into the future. I'll now hand the call back over to Steve for guidance and closing remarks.

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

Thanks, Neil. The company's current forecast for light vehicle production for the third quarter of 2022 and full years 2022 and 2023 are based on the mid-July 2022 IHS Markit forecast for light vehicle production in North America, Europe, Japan, Korea and China. Light vehicle production in these markets is expected to increase 21% for the third quarter of 2022 as compared to light vehicle production for the third quarter of 2021. For calendar year 2022, light vehicle production in these markets is forecasted to increase 4% when compared to calendar year 2021.

The company continues to expect that revenue will remain difficult to forecast for the remainder of the year as a result of high levels of volatility in customer orders and vehicle production volumes, electronic supply chain constraints, labor shortages and overall economic uncertainty. Based on the updated light vehicle production forecast as well as the year-to-date financials, the company is updating certain guidance estimates for calendar year 2022 to the following: Revenue for 2022 is expected to be between $1.87 billion and $1.97 billion. Gross margins for the year are expected to be between 33% and 34%. For operating expenses, we are maintaining our initial guidance of $230 million to $240 million. Our estimated annual tax rate, which assumes no change to the statutory rate is forecasted to be between 15% and 16%. Capital expenditures for 2022 are expected to be between $125 million and $150 million, depreciation and amortization is forecasted to be between $100 million and $105 million.

Additionally, based on the company's forecast for light vehicle production for calendar year 2023, the company still expects calendar year 2023 revenue growth of approximately 15% to 20% above the 2022 revenue guidance. As we look back at the quarter, we did see some stabilization in our sales levels due to the significant amount of redesign work that we have completed over the last several quarters, and we have observed some modest improvements in the overall supply base.

Unfortunately, many of these improvements were offset by new component shortages and customer order changes and volatility that we expect to continue throughout the rest of 2022 and into 2023. Despite these challenges, we still believe that the overall backdrop in the industry should lead to a demand increase in the automotive market over the next 12 to 18 months and will be supported by growth in Full Display Mirrors, exterior auto-dimming mirrors and other new technologies that we have been investing in over the last few years. So while we acknowledge that the inflationary aspects of our business will remain a challenge that needs to be addressed, we are optimistic about our growth opportunities driven by our commitment to new technology and our team's ability to handle the cost challenges that are inundating our industry.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Luke Junk with Baird.

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

Hoping to start with cost recoveries from here and really qualitative questions. So having had another quarter to continue engaging with customers on managing inflation jointly. Just wondering whether you'd say you're feeling same or better versus 90 days ago? And specifically, what does that mean for gross margin as we look at the glide path looking out to 2023 and beyond in addition to what you've indicated for the second half of this year?

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

Yes. So I would tell you, we actually feel a little better than we did even last quarter. And the reason for that is we've had more substantive conversations with our customers about the details, what's happening on the material side. and on the labor side and costs in general. And we're starting to make some progress. We've actually been able to already lower some of our existing APR commitments, and those haven't necessarily resulted in price increases yet at those OEMs, but we have been able to lower what we had previously committed to on APRs.

And so those are some of the improvements that we're starting to see and we're having pretty good conversations about the cost escalation that's happening in the industry. As it relates to the 2023 and beyond forecast, we know we're not going to get 100% recovery from the cost increases because a lot of those are internal, not just bill materials. But we still believe that given a fair amount of time and 6 months may be not enough to get the full offsets in place. But we do believe by mid-2023, we should be back hopefully to that 35%, 36% range.

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

Okay. And then follow-up question would be on FDM shipments. I'm just wondering if you're able to give any sort of midyear indication of where we here in July, either in absolute terms or just relative to what your expectations were coming into the year knowing that the main issue here is just what level of components you can source.

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

Yes, for the year. And actually, we've had a lot of challenges, as we've talked about in the past about components, especially with our higher-end content of parts. The team has done a phenomenal job and a lot of the redesigns are around Full Display Mirror and being able to get alternate solutions to the market. So we're still feeling pretty good about our -- like we discussed last quarter, our current trajectory for our units for this year. We're able to achieve and meet shipments. Obviously, we hope the components part gets better, so we can stop doing redesigns. But we feel like we're still on target for what we talked about last time.

Operator

Our next question comes from David Kelley with Jefferies.

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

Maybe starting with a quick clarification on the gross margin guidance. Does that assume any kind of incremental traction and pricing pass-throughs in the back half of the year?

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

No. Yes. Right now, we're not modeling or trying to predict what the net effect of price increases could look like if we're able to get those to our customers.

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

Okay. Perfect. And then maybe a high-level question on the supply chain. It sounds like you were starting to see some improvements there. But at the same time, new shortages seem to be emerging. So can you walk us through maybe where things are getting better, where things are getting incrementally worse? Is it specific component areas? Is it regional? Just looking for kind of some color on the moving parts there.

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

Yes. If you look back over the last year, there were various times when we would have 50 to 100 components, individual discrete components that were concerned. Some of those very, very concerning. Others just concerning in that we didn't have line of sight of how we could get enough volume to support customer volumes. If you look at this past quarter, I would say we're probably down to about 5 or 10 components at a time that are that are really hot yes. So I mean the total number of components you're dealing with. Now the severity of each one of those when they do happen, that's the part that hasn't improved. Like when a component goes down, it's immediate and it's severe, and there's usually not a lot of lead time or a lot of heads up given by the supply base in terms of what they're going to be able to support. So the total number of problems we're handling is dropping. Unfortunately, we just haven't gotten to that point where the severity has gotten better yet.

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

Okay. Got it. And then maybe one last one. On the customer order changes, are you seeing any outright kind of cancellations? Or are the changes still more a function of ongoing volatility and just the unpredictability in the supply chain?

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

Yes, correct. No full cancellations. It's more -- you'll get released data that says, hey, in the next couple of weeks, you got to have 100,000 parts of this part number already. And then when it comes time for delivery, they'll take 10% less than that. And so they'll shove those orders into the following weeks. And so it just kind of keeps cascading and moving out. But we've not had a single instance of a cancellation of a program or project.

Operator

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

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

I guess looking a little bit further out, it sounds like the gross margins are probably troughed this quarter and on track over the next so to return to historic levels. But I'm kind of curious how you kind of feel internally about the 8% light vehicle production growth for next year that IHS is projecting and kind of of the assumptions that are around that? And also any commentary on how these kind of low inventory levels that we have could help potentially buffer any kind of slowdown that we see economically?

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

Yes. So the first part of it, we have been really over the last 18 months, a little bit more pessimistic than IHS has been on overall vehicle production volumes. So our guidance both through the second half of this year and through all of next year is assuming a slightly lower LVP than what IHS is showing currently. And we still -- even with that slightly lower LVP and in 2023, we still think we can get that 15% to 20% growth range.

And so it's a little more conservative than what the industry itself is showing for next year. But our outperformance should be right in line, if not slightly even better than what it has been so far this year. In terms of the macroeconomics, this is probably one of my favorite conversations. There's a ton of variables obviously playing. Like I mentioned in the prepared comments, the backdrop is actually really, really good. If you look at -- there seems to be plenty of demand for vehicles. Inventories are incredibly low still. All these things should favor an environment that would be good for us in terms of ability to have stable demand over the next 12 to 18 months. The single biggest risk factor right now is affordability in the federal funds rate and what's going on with the consumer and what is going to become affordable. Obviously, as a content provider, 1 of the things that we look at is what is the average sale price of a vehicle.

And typically, it's not that cars won't sell. It's what is that average value or average transaction price, and that's 1 that we watch very closely. So far, we haven't seen any changes to that. But a lot of that has been driven by OEMs and the fact that inventories are so low. So we're hopeful that things will continue. But I'd say those are kind of the competing forces right now in the space.

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

And then the company has been pretty consistent towards outperformance relative to the light vehicle production in your markets. I guess, could you elaborate a little bit on some of the forces that are driving that? Because I know historically, or at least recently, FDM shipments have been a little bit more limited. Are those coming back stronger? Or is it other areas that you're seeing like China that you mentioned that are help driving that outperformance?

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

Really, it's been across the board. I mean, penetration rates of our core auto-dimming products with interior and exterior have been doing well. Obviously, FDM has been doing really well. The biggest challenge we have on FDM is not demand from our customers is our ability to get components. So literally, when Neil mentioned up to 30% of his engineering team's time has been on redesigns. It's in support of that. And there's literally been instances in the last 2 quarters where we've had to tell OEMs, we can't increase volumes to what they would like them to be because there's just not availability of components. And so it's been very chaotic, a tremendous amount of work from the team just to get to this level.

There's definitely more demand on the OEM side for FDMs right now than what we could produce.

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

Are you able to quantify that? I mean are you able to get back to like a more typical cadence where your adding 200,000 or 300,000 additional FDM shipment units this year? Or is it going to be a little bit more constrained, but better than last year?

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

No, I think it will be just like that several hundred-thousand-unit growth rate on a year-over-year basis. By the time we get to the end of this year, I think we'll be right in line with that again.

Operator

Our next question comes from Mark Delaney with Goldman Sachs.

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

The first one is on gross margins from me as well. If I heard correctly, you're talking about gross margins getting into the 35% to 36% range, middle of the second half of 2023. Maybe you can talk about what things may still be constraining gross margins in that time frame relative to the upper 30% range that the company had been doing and in some of the recent quarters. What headwinds still remain into [FY '23]?

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

Yes. I think the primary focus there is that we know there will be some material cost increases that we won't be able to fully get remunerated for from our customers. If you look at what we're working on with them is kind of taking a long approach in terms of cost increases and what's happening on the material release side. So we believe that will create some headwinds, obviously, normal kind of pricing models. And then the other 1 is mix. Neil talked about some of the strong growth we're seeing in base auto-dimming growth in the China market. Those products do tend to be slightly below corporate average. And so as we're growing to help us offer up more higher-end technology in the future and also outside auto-dimming. It all starts with an inside auto-dimming mirror. Unfortunately, they are below corporate average margin profile. So as we deliberately try to grow that business, it does have a headwind effect in terms of overall corporate profitability.

But strategically, it's something that we believe will help us grow and produce the type of content that we think we can get in the China market longer term. Beyond that, some of the things that we talked about in terms of headwinds this quarter will last. So some of the labor cost increases. We're hopeful that some of the logistics costs start to go away finally. But it's been 18 months of logistics challenges. So we're still anticipating that come even next year. There'll continue to be some higher costs associated with freight globally.

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

Okay. That's very helpful. My second question is just trying to better understand how you guys are thinking about the macroeconomic environment. And it sounds like you guys are putting a lot of thought into it, and we're all seeing some of these headlines around pressure on consumer spending with inflation and some layoff to various companies. You guys have kept the top line outlook that you had for next year despite some of these we mean economic data points. I'm just curious if you can talk a little bit more, are you trying to factor in some weakening in the economic environment with that top (inaudible) 3. Or is that -- if the economy does slow, is that for perhaps on (inaudible) the number you're articulating?

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

Yes. No, I think everything we look at, we kind of take a very careful look especially at the vehicle production forecast levels, but also our revenue in general and try to understand and estimate that whatever we're seeing or whatever our customers are telling us is probably going to end up being 3 -- 2% to 4% higher than what it's really going to come in at. And that's kind of our first take at what is the overall economic impact of these factors and what kind of a moderating influence will have in the industry. Now so we do that manually.

We actually do a full bottoms-up forecast, which is part number by vehicle take rate based on what our customers are telling us. And then we true that up based off of our belief system or what's happening in the overall market conditions. All those things being said, and I think our conservative approach has fared us fairly well over the last 18 months, I think we are probably one of the few suppliers that talked about the component issue a long time ago before it became quite as catastrophic as it has been in the last 12 to 18 months. But if you look overall, what we're focused on as a company, we still believe that our product portfolio is what's going to drive that growth. And we still believe that the customers will resonate towards the higher-end electronic features.

There are some other features that potentially have -- will become more troubled over time, not just ours, but in the industry as a whole. And we really truly believe that we have a winning product portfolio right now.

Operator

(Operator Instructions) Our next question comes from David Whiston with Morningstar.

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

First, can you just talk about how much need you have relative to, say, a year ago, 6 months ago to add people on the line?

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

Yes. There's still some labor shortages that we're dealing with. We have made some progress from the beginning of the year. But when we look at these growth rates that we're talking about, we're going to need even more than that. So we're still running some overtime currently. We do have a little bit of capacity in place. But for the growth rates that we're seeing over the next 18 months, people will definitely be one of the challenges we'll face.

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

And I know you've had some success with that Spanish-only speaking, production line hiring program. Is there enough additional Spanish-speaking labor in the area to expand that? Or have you already maxed that out?

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

No, we haven't maxed it out yet. And I think we're up to a little over 130 people currently in that program, and we're actually actively recruiting and trying to expand that. And now we're -- it's kind of a nice story in that what we're really looking for now is helping people to become leaders and supervisors inside of that facility to make sure that they have a career path and then can help us grow that program even further. So it's one thing to have the employees. It's a lot of work then goes into making sure that we're developing people so that we have supervisors and what we call group leaders to be able to manage those lines.

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

And then moving on to capital allocation. I guess a 2-part question there. No buybacks this quarter. So I guess, one, are you -- does that perhaps suggest you're a bit more worried about the future, given there's a lot more concerns about inflation and a recession in the past few months. But then also on the dividend, that's been essentially flat for nearly 3 years. Just where do you see that remaining? Do you want more certainty before increasing the dividend?

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

Yes. Our dividend -- thanks for the -- I mean, the capital allocation conversation because it is an important part of what we look at every day. The dividend, our philosophy there is basically the dividend will move roughly in line with net income growth. And obviously, over the last 3 years with the with the challenges that happened in the industry in COVID, we took a careful approach to the dividend. And obviously, in this last couple of quarters, what we've seen is underperformance in net income so we're just holding that dividend stable until we get back to the place where we're seeing net income growth on a true basis. As it relates to share repurchases, it's not that we are worried about overall long-term health of the company or anything else as it relates to why we didn't make purchases.

That was all focused on inventory. Our goal is to take the money that we had historically been spending on share repurchases and make a deliberate attempt to raise the overall inventory levels of the business to try to help protect our customers and ourselves from component shortages. And so what we wanted to do is just say, "Hey, listen, let's make sure we have as much capital available to make those guarantees to the supply base to try to get our hands on as many parts as humanly possible.

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

So basically, you wanted to increase raw material inventory, is that fair?

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

Correct.

Operator

Our next question comes from James Picariello with BNP Paribas.

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

Just thinking about the guidance here and last quarter, the communication that 1Q was set up to be kind of the low mark from both a revenue and margin standpoint. And I understand second quarter maybe came in relative to April, maybe a little bit lighter. But it just seems as though there's a lot more now involved from your specific supply chain sources and the redesign efforts. I mean how much of this is attributable to 1 or 2 very important customers for you? What really has surprised you? Because I mean, now it seems as though the 1Q might be certainly not the low mark, right? It might be actually the high mark for the year. We'll see how the rest of the year trends. But what really has surprised you guys? And is it attributable to 1 or 2 key customers?

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

Yes, I think there were 2 -- I would say there were 2 things that actually surprised me. And the 2 things were that given how low -- how easy the year-over-year light vehicle production comps should have been for 2 the fact that from the beginning of the quarter to the end of the quarter, that vehicle production dropped 4% and from what was estimated to what actually happened. And if you take that 4%, that would have parlayed pretty linearly for us into direct revenue. And so that one was surprising because these are not super high levels of production. And really what comes with that is the OEMs struggle to be able to get the resources they need to produce cars faster, whether that's materials from the supply base or even labor to build at rates higher than what they are currently. And so that one was pretty shocking because it should -- in theory, it should have been fairly easy to get the increases in LVP in Q2 that they were forecasting.

It wasn't a really high hurdle rate by any stretch of the imagination. So that one was surprising. And then the second one I'd say is surprising is the continuing -- we felt like at the end of Q1, we had knocked down most of the component issues. We are feeling pretty good about that. In the quarter, a couple more came up that were quite honestly pretty surprising. So those are the 2 surprises for me for the quarter.

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

And are these primarily chip related?

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

Yes.

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

Or I mean, a lot more involved in that?

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

No, it's primarily electronics.

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

Okay. And then for the back half, I mean I think most indications from others will be, obviously, we're on the front end of earnings, but that the second half semi supply will continue to improve. But it does sound as though the redesign element to your customer relationships is playing a more significant factor, and that's showing up in maybe slightly lower outperformance baked in for the second half? And then also margins facing a little added pressure. So yes, can you maybe just unpack the idea of your need to redesign and why the second half margins would be affected if chip improvement is going to play out?

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

Yes. I think on the redesign side and component availability, we are in a unique situation there. If you look at a lot of what we design. We try to stick with a lot of kind of common designs whenever possible, meaning you have some exposures to, obviously, some unique electronic components as well. And so because of the product portfolio that we have, these are very unique products. So a lot of times, we have some unique components that go on them as well, meaning you could be a little more susceptible to variation in production than, say, a very high volume component that's used by 20 different Tier 1s across the globe. So that's one factor. If you look at the other side of the component issue, I wouldn't say that we're more impacted. What I would say from our standpoint is that we're probably more proactive than a lot of suppliers in terms of the fact that we'll redesign this and begin that process before we even have an OEM approval, or even a buy-in to handle it. We believe that in our position that it's our obligation to make sure that we're taking care of our customers as quickly as possible.

And so we tend to be very proactive about that. some of the redesign work that's been going on from the team is less focused on it's going to happen or it's happening right now to this is a risk factor, how do we get a new component in place, a new circuit design in place to be able to protect in case the worst case scenario plays out. And so we've been very proactive in that in that space, and we believe that's going to help us as we move through the next 3 to 5 years in terms of confidence from OEMs, ability to get sourced new projects and not pulling punches or waiting for OEMs to guarantee support before we start moving on those redesigns.

And so historically, our reputation in the industry has always been one of a very proactive supplier who will always take that leap of faith and start those redesigns even before the guarantees are in place. And so we've been living up to that reputation.

Operator

Are no further questions. I'd like to turn the call back over to Josh O'Berski for any closing remarks.

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

Thank you, everyone, for your time and questions today. This concludes our conference call.

Operator

This does conclude the call. You may now disconnect, everyone. Have a great day. The conference will begin shortly.