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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gentex First Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded.

I would now like to turn the conference over to Mr. Josh O'Berski, Gentex Director of Investor Relations. Sir, you may begin.

Josh O'Berski

Thank you. Good morning, and welcome to the Gentex Corporation First Quarter 2018 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. This call is live on the Internet by way of an icon on the Gentex website at www.gentex.com.

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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 2018 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 first quarter 2018 financial summary. Steve?

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

Thank you, Josh. For the first quarter of 2018, the company reported net sales of $465.4 million, which was an increase of 3% compared to net sales of $453.5 million in the first quarter of 2017. When compared with the company's mid-January forecast for the first quarter of 2018, light vehicle production in the company's primary regions declined more than 3%, which resulted in lower-than-expected unit shipments and revenue during the quarter.

On a year-over-year basis, automotive light vehicle production in our primary markets decreased by approximately 3% versus the previously reported production numbers from IHS for the first quarter of 2017. Additionally, a supplier production issue for certain electronic components affected our ability to meet demand for Full Display Mirrors, which resulted in shortfall of approximately 2% in revenue during the quarter. However, since the end of the first quarter of 2018, the supplier production issue has been remediated, and normal shipments of the impacted products have resumed.

While we were disappointed with the overall revenue performance during the first quarter of 2018, we were able to outperform our underlying markets by approximately 6% when you consider the lower automotive production levels during the quarter. And when you combine that with the missed shipments for Full Display Mirror, our performance represents an 8% growth rate versus the underlying market.

When compared with the first quarter of 2017, the gross margin declined from 38.8% in the first quarter of 2017 to 37.1% in the first quarter of 2018, primarily as a result of inability to leverage fixed overhead costs, resulting from the lower-than-forecasted sales growth and the missed shipments during the quarter.

Additionally, annual customer price reductions negatively impacted the gross margin because they were not fully offset by purchasing cost reductions. As we have stated previously, our customary annual price reductions become effective on January 1 of each year, but purchasing cost reductions don't materially begin to offset that margin pressure until sometime during the second quarter. We are currently expecting positive leverage on gross margins for the remainder of calendar year 2018.

Income from operations for the first quarter of 2018 decreased 4% to $128.5 million when compared to income from operations of $134.4 million for the first quarter of 2017 due to the lower quarter-over-quarter gross profit margin percentage. Net income for the first quarter of 2018 increased 14% to $111.2 million compared with net income of $97.6 million in the first quarter of 2017. Earnings per diluted share in the first quarter of 2018 increased 21% to $0.40 compared with earnings per diluted share of $0.33 in the first quarter of 2017, as a result of a lower effective tax rate and a reduction in diluted shares outstanding on a year-over-year basis.

During the first quarter of 2018, the company repurchased 9.3 million shares of its common stock at an average price of $21.71 per share. Of these share repurchases, 5.5 million shares were repurchased from the former CEO, pursuant to his previously disclosed retirement agreement at a price of $20.98 per share. As previously announced, these share repurchases were separately approved by the company's Board of Directors and were not repurchased as part of the company's existing share repurchase plan. As of March 31, 2018, the company has approximately 26 million shares remaining available for repurchase, pursuant to its previously announced capital allocation strategy and share repurchase plan. The company intends to continue to repurchase additional shares of its common stock in the future in support of its previously disclosed capital allocation strategy, which may vary from time to time, depending on macroeconomic issues, market trends and other factors that the company deems appropriate.

During the first quarter of 2018, the company paid down debt on the company's term loan of $28 million during the quarter. The company expects to continue, based on previously disclosed factors, to pay additional principal during the second and third quarters of 2018 in anticipation of such debt maturing on September 27, 2018.

I will now hand the call over to Kevin Nash with first quarter 2018 financial details.

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

Thank you, Steve. For the next few minutes, we would like to spend some time discussing the details of the first quarter, key factors that drove the first quarter results and points of consideration as we move through the remainder of 2018.

Other income increased to $3.2 million in the first quarter of '18 compared to $0.4 million in the first quarter of 2017, primarily due to increased interests, net of expense of $1.4 million, with the balance split between foreign exchange gains as well as realized gains on sales of equity investments, which is consistent with our capital allocation strategy press release earlier this year. As part of the capital allocation strategy, the company has eliminated its previously held equity investments, many of which were sold for a gain and created part of the outperformance in other income for the quarter. We believe that our new balance sheet strategy will provide other income of approximately $6 million to $8 million on an annual basis, assuming current interest rates.

During the first quarter of '18, the company's effective tax rate was 15.6%, down from 27.7% during the first quarter of 2017, primarily driven by the impacts of the Tax Cuts and Jobs Act of 2017. When excluding discrete items for the quarter of $1.5 million, the effective tax rate was 16.7% for the first quarter of 2018.

Automotive net sales in the first quarter of 2018 were $455 million, an increase of 2% compared with automotive net sales of $445.6 million in the first quarter of '17, driven by a 7% increase in auto-dimming mirror unit shipments on a quarter-over-quarter basis. Other net sales in the first quarter of '18, which includes dimmable aircraft windows and fire protection products, were $10.5 million, an increase of 32% compared to other net sales of $7.9 million in the first quarter of '17.

Now moving on to the balance sheet. The following balance sheet items represent a comparison versus December 31 of '17, which are also included in today's press release. Cash and cash equivalents were $524.3 million, down $45.4 million from $569.7 million, primarily due to cash flow from operations that were more than offset by share repurchases, accelerated debt repayments, capital expenditures and increased dividend payments per our capital allocation strategy. As part of the capital allocation strategy, we announced the lowering of our overall cash position down to a target of $525 million. Short-term investments were $152.2 million compared to $152.5 million. Long-term investments were down $57.8 million, in conjunction with the company's previously announced capital allocation strategy. Accounts receivable was $246.4 million, up from $231.1 million, primarily due to higher sales levels on a period-over-period basis. Inventories were $207.2 million, down from $216.8 million, primarily due to lower raw material and finished good levels. And accounts payable decreased to $77.3 million from $89.9 million. And accrued liabilities were $150.8 million, down from $153.8 million, driven by timing of certain wage and tax payments, which were partially offset by accelerated debt repayment.

A few cash flow highlights. The first quarter of 2018 cash flow from operations was $147.4 million versus $131.2 million in the first quarter of '17, driven by changes in net income and working capital. And capital expenditures for the first quarter of 2018 were $26.2 million compared with $27.1 million for the first quarter of '17, and depreciation and amortization was $28 million compared to $25.2 million in the first quarter of 2017.

I will now hand the call over to Neil Boehm for our Full Display Mirror and product launch update.

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

Thank you, Kevin. In the first quarter of 2018, there were 10 new nameplate launches of our inside and outside electrochromic mirrors and electronic features net of previously disclosed feature headwinds. During the first quarter, approximately 60% of the net auto-dimming mirror launches contained advanced features. The first quarter was highlighted by increased launch levels in HomeLink and Full Display Mirror.

Now for an update on our Full Display Mirror product. I'd like to start by giving a comprehensive update of all currently shipping Full Display Mirror programs by nameplate and OEM. As many of you may remember, General Motors was our initial launch customer for Full Display Mirror, and we now have 9 nameplate shipping. These nameplates are as follows: Chevy Bolt, Chevy Traverse, Buick Enclave, Cadillac CTS, CTS-V, CT6, XT5, Escalade and Escalade ESV.

Our next OEM customer for Full Display Mirror is Subaru. For Subaru, we have 2 nameplates sourced: the Subaru Levorg and the Subaru Ascent. The production shipments for the Subaru Ascent will begin in the second quarter, and the Full Display Mirror will be available in the North American market. This is the first Subaru vehicle to offer Full Display Mirror in North America. As you may remember, the Subaru Levorg launched Full Display Mirror in Japan, Europe and Australia. The rollout of Full Display Mirror at Subaru confirms that it is a globally accepted product, and we believe that it will be relevant in all of the company's primary markets.

For our third OEM, Toyota, we are currently shipping on 2 nameplates. The Lexus LS and the Toyota Alphard. Both of these nameplates are currently shipping in the Japan market.

With our fourth OEM, Nissan, we are currently shipping on 2 nameplates: The INFINITI QX80 and the Nissan Armada.

As we look forward to the balance of the calendar year, we have several additional nameplates that are scheduled to launch with these initial customers. We are currently planning to begin shipping at -- on at least 6 additional nameplates through the rest of 2018 and are still on track to achieve shipping our targeted 500,000 units of Full Display Mirror in 2019.

Now we'd like to switch the focus toward another technology for the company and provide an update on the sales and business development activity surrounding our Integrated Toll Module. In February, Audi announced that they were going to be the launch customer for our Integrated Toll Module product. In Audi's press release, they referenced that the production was anticipated for later in calendar year 2018. Over the last 2 years, we've been working diligently with Audi, solving the technical hurdles associated with this technology, and we're excited to see ITM debut with this automaker. We continue to see a lot of interest from other automakers about this product and are confident that we'll have further awards to announce later this year.

I will now hand the call back over to Steve for 2018 and 2019 guidance and closing remarks.

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

Thank you, Neil. Based on the April 2018 IHS light vehicle production forecast for our primary regions, current forecasted product mix and expense growth estimates, the company continues to maintain its previously announced annual guidance ranges in each of the following areas: revenue of $1.89 billion to $1.97 billion, gross margins in the range of 38% to 39% for the year, operating expenses between $180 million and $190 million, capital expenditures between $115 million and $130 million and depreciation and amortization between $105 million and $115 million.

Additionally, the company is maintaining previously announced revenue guidance for calendar year 2019 to be between 5% and 10% above 2018 revenue estimates. After further analysis and refinement, the company is lowering its estimated effective annual tax rate from previous guidance of 18% to 21% for calendar year '18 to a range of 15% to 18% for the year. This is primarily as a result of further detailed analysis of components of legislation related to the Tax Cuts and Jobs Act of 2017, R&D tax credits as well as discrete tax benefits related to equity compensation.

For the first quarter of 2018, it was a challenging quarter, but the company continues to be focused on creating long-term growth, driven by unique technology platforms, while executing with operational discipline designed around shareholder return. We remain steadfast in our efforts to provide unique, value-added solutions for our customers that provide scalable platforms focused on the consumer and engineered specifically to each OEM's requirements. This strategy is what we debuted at CES in January of '18, where we introduced several new technologies that continue to garner strong interest from our customers and we believe will provide growth for the company over the next several years.

We want to thank you for your time today, and we can now proceed to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Christopher Van Horn of B. Riley FBR.

Daniel Lemont Drawbaugh - *FBR Capital Markets & Co., Research Division - Former Associate*

This is Dan Drawbaugh on the line for Chris. So just to start, I wanted to talk about FDM, a couple of questions there. On the supplier issue, is it fair for us to assume that there is going to be some revenue from the first quarter pushed into the second quarter since that issue has been resolved?

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

Yes, we think there'll be a little bit into the second quarter. Really, we think it'll be pretty evenly spread. We didn't -- in other words, we didn't shut down a plant or anything. There were enough products in production and in shipment to those customers that it didn't affect the customer at all. So there's not like there will be a huge catch-up. Really, we think that catch-up period will be spread out over a longer period than just Q2.

Daniel Lemont Drawbaugh - *FBR Capital Markets & Co., Research Division - Former Associate*

Okay. Great. And then on the 6 additional nameplates that I think you mentioned that you expect to launch later this year, do you have any sense of the content that you'll have there? You have the camera content? Or will it be more mirror focused?

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

Yes, for that one, it'll be -- let's see, it's a combination of both. We have a little bit of camera and mirror and more. I would say in this -- I'm sorry, in this year, out of those 6, most of them will be display mirror only, and there are a few that will be camera as well.

Daniel Lemont Drawbaugh - *FBR Capital Markets & Co., Research Division - Former Associate*

Okay. Got it. Very helpful. And then I know you've got Jaguar Land Rover signed up to be the first customer for HomeLink Connect, and I was hoping you could talk a little more about the timing of that rolling out. When you might expect that? And I was also curious how conversations with other OEMs are revolving around that technology.

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

Sure. First of all, on the Jaguar Land Rover one, we're releasing that app later this year, late summer into fall. And then I think the production side of that, it's going to start very soon after that. In regards to other interest from customers, there is quite a bit of interest in deploying that from 2 additional customers that we're currently working on.

Daniel Lemont Drawbaugh - *FBR Capital Markets & Co., Research Division - Former Associate*

Okay. Got it. Great. And then final question for me, I just wanted to ask more broadly, at CES, you showed your immersive product display and then a number of dimmable features aside from the mirror. And I was curious to know what the OEM response was to that and what you're thinking was around when you might get some of those products out into production and on vehicles.

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

Yes, great question. The interest from the OEMs was quite high. We continue to do the typical business development activities post-CES that you would expect, so a lot of tech days at OEMs and showing devices and really talking through the capabilities of the underlying technology. This is a pretty far out -- I mean, you have to look at this is probably -- I think it's safe to say you'd -- looking probably in the 5-year out horizon before we're ready to do anything kind of on a commercial deployment side. And the reason for that is there's a lot of technical hurdles we have to get past, and there's a lot of engineering work that needs done, and then obviously OEMs have to understand the capability of that and make the determination of whether or not that product is a good fit in their vehicles. But what I would say is, from a overall interest level, it's probably one of the stronger interest products that we have ever shown at CES.

Operator

Our next question comes from the line of Rich Kwas of Wells Fargo.

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

On -- so on this $9 million with FDM, were there any -- did you incur freight costs, expedited freight costs? How much did that impact margin? And I mean, broadly speaking, within the decline, how much of that was really specifically to this FDM issue?

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

Well, within the decline, yes, like the $9 million you mentioned, if you think about the margins of FDM, that impacted gross margins around 30 basis points and then outmargins about 40 basis points because of the expedited freight costs really are in that SG&A line. So that's really the -- if you encapsulate what that impact was on the quarter, that's really kind of what it was.

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

But yes, there were -- there is a lot more work both that did affect gross margin. That's what Kevin is referencing there, is really kind of the loss profitability associated with the loss revenue. But there were additional costs that we incurred, obviously on the labor side and manufacturing inefficiencies associated with trying to get the problem resolved, a; and then obviously get the parts back from the customer and make sure we're handing those appropriately. Like Kevin mentioned, there were costs in the SG&A line item as well for expedited shipping costs and some of the work that had to go on there.

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

And then apart from that, your gross margin was down. I know you have the price reductions and whatnot that occur every year in the first quarter. But was that worse than you expected? Was it mix related? I mean, I know there's probably something related to volume side of things where it wasn't as strong as what was initially thought at the beginning of the quarter, but just trying to flush out what was the mix or what other impacts that were on gross margin were.

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

Probably 2 -- yes, 2 factors, Rich. Thanks. It's a great question. I think the biggest factor, if we look on a year-over-year basis, is really when sales come in at, call it, 3% or 2% growth, you're not leveraging the overhead because we're making investments in the capital side of the business. So that was about 170 basis point reduction just on the fixed overhead side, which had we come in with the FDM and then production then where we thought it was even at the beginning of the quarter, I think we would be talking a different story on margins. And then the rest of it is the APR side with most of our price reductions starting on January 1, and then our purchasing PPV or cost reductions on the purchasing components not really taking any meaningful hold until, call it, mid- to late Q2 and then beyond. Some of it what we've seen in prior years.

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

So that -- Kevin, that 170, is that just the fixed overhead on the volume side, that impact?

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

Yes, if you think about the fact that we were -- some of that stuff was being replaced. Our mix, on a year-over-year basis, wasn't strong as well. That was a smaller factor. But if we're growing our base mirror units like you saw, we had 7% growth in units, and that really indicate that base mirrors are growing ahead of the curve, which tends to have a drag on margins as well.

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

And so combined, between FDM and the fixed overhead issue, is like 200 basis points, right, on gross margin?

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

Yes, yes.

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

Well, I think -- and Rich, just to further that on, I mean, if you look at the actual pricing impact, there's nothing on the line about our APRs. It's right in line with what we've guided to historically, so there's no additional pressure as it relates to pricing from our customers. It's really that, that fundamental difference, as the one Kevin described, is mix issue. So base mirror mix was a little higher in the quarter than what we were anticipating, and especially base inside mirror, and that obviously is the negative headwind as it relates to the margin profile between advanced features and base auto-dimming.

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

And does this -- given the slow start of the first quarter -- I mean, I know you have your range for gross margin. But does that -- what's the risk that you'll end up at the lower end versus the midpoint, I mean, at this point?

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

Yes, I'd say that's -- I mean, that's the -- that would be the biggest risk factor for the year, is margin profile, is that was a bad start in Q1, obviously a quarter of the year now outside of the range. The risk would be is that we end up at the bottom end of the range, and that's really -- and that's where we're going to be a focus of how the year progresses from a growth standpoint. We think Q2 will be a little lighter towards the bottom end of the growth rate range for revenue, but we really expect Q3 and Q4 to be at the higher end of the growth rate range for the annual guidance. So if you look at throughout the rest this year, we think Q2 will be a little bit more of a challenge, kind of like what Q1 is, obviously better than that but still a challenge. But Q3 and Q4, we're anticipating to be quite a bit better.

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

Okay. Last quick one on North America. So the shipments grew in line with production. I think this is the second consecutive quarter that's happened. I mean, what -- how should we interpret what's going on there, timing, et cetera? How do we think about that as we go forward the rest of the year?

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

Well, if you've looked at the breakdown of North America specifically, exterior mirrors were fairly weak. And I think we talked about last quarter or the prior, we had a packaging issue at one of the North American OEM. So it wasn't a [decontam], but it was moving at upper trim level, if you will, so they're taking it less on the mid-level trim on an exterior platform. And so that's really what the pressure was, it was 1 specific program, primarily that cost pressure in North America. And like we've talked about in the past, Rich, also, most of our growth in North America is going to be content-based, be it FDM or HomeLink or those type of things, and probably not outpacing growth in the production levels of North America.

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

And the reason why is that the current penetration rates are already at their highest levels in North America. So you're north of -- you're probably in the 55% or so range of inside mirror penetration rate in the North American market already.

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

Okay. So it's going to be content, electronics, et cetera. Okay. All right.

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

Correct.

Operator

Our next question comes from David Leiker of Baird.

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

Just one thing I wanted to kind of dig through. So you've held your guidance for the year, and if we look at what that implies for the growth rate over the course of the year, there's an acceleration on that rate of growth, particularly relative to where build rates are. Is that something we see in Q2? Or is that something that's more back-end loaded than that?

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

Yes, I think Q2 will be -- we're -- we believe Q2 will be a little bit better than Q1. But really, we think there'll be some acceleration in growth rate in Q3 and Q4. And so we would -- if we're looking at our annual guidance range, we'd say Q2 is likely to be towards the bottom end of the annual guidance range of growth rates. But Q3 and Q4, we'd expect to be at the higher end of the growth rate range.

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

And then is that a pace of growth? Obviously, we have the comparison issue in Q1. But is that a pace of growth that is then more sustainable over the coming years? Or is that just something we're going to see for a few quarters and then slow down a bit?

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

Well, we think it may -- maybe the midpoint or the average of some of those. But if you look at our guidance for '19, still maintaining that 5% to 10% growth rate for '19, we feel comfortable with the rate of launch that we have, the penetration of our products, the technology that we're adapting into those, including Full Display Mirror and some of the new things that we're bringing to market. And we think those are showing signs of life. We look at -- the only thing officially we've given guidance on is obviously '19, but we definitely feel comfortable with that growth rate range of 5% to 10% for next year.

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

Great. And then just 1 item to close the loop here. If we look at the Full Display Mirror and maybe even across the other features, are there any changes? Or what are you seeing in terms of take rates relative to what you've expected for those products, the newer products that you're bringing to market?

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

Sure. There's -- like anything, because there -- because of the number of OEMs we're shipping on, you -- as you can kind of reasonably expect, there's ups and downs in that from a take rate perspective. But if you look at the big picture in terms of our target of shipping 0.5 million units next -- some -- throughout next year, we're right on pace with that, and so we feel really good about how the product is being received by the consumers, how OEMs are deploying that. Obviously, on certain platforms, you would -- you always hope for more content and take rates, but it's kind of right in line with what we were expecting. And OEMs have been very good about their prediction of how they're going to deploy this technology, and they've been sticking to those execution plans. And so far, the feedback seems to be quite good from a consumer base.

Operator

Our next question comes from Ryan Brinkman of JPMorgan. Our next question comes from the line of Anthony Deem of Longbow.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

So to start off, were you aware of this FDM supply risk when guidance was introduced in late January? Or is this more of a February, March event? Because I'm just wondering how much of that 40 basis point EBIT margin impact is factored in the guidance. Or maybe if identified other offsets for the remainder of the year that enabled you to maintain guidance?

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

Yes, I mean, really, it happened in the quarter. So we -- I think it's about midpoint through the quarter actually when the event kind of happened. So really between that point when it happened and today, getting it identified, resolved and working through that has been a tremendous amount of work, so we're proud of the team for the effort and work they've done to pull that off. In terms of what gives us the confidence to look at offsets throughout -- through the rest of the year, it's really looking at -- part of that is a onetime event, part of it is the normal cycle of our business knowing that the first quarter tends to be the toughest from a margin performance standpoint, looking at Q2 and our purchasing reduction that we're expecting from our supply community over the course of the year and then the accelerated growth rates throughout the calendar year and the impact that typically has on margin performance. When we look at that weighted average, even with the rough start to Q1, we still feel comfortable with our business model and the annual guidance range that we gave.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Okay. And are you able to share the run rate for FDM? If you're in 2018, I guess, your comments might imply, let's say, half the quarter might have been impacted in terms of FDM shipments from a supply issue. So I kind of -- back of the envelope, maybe 35,000 units on a $250 ASP. So are we kind of at a 70,000-unit quarterly run rate here so far? And is -- any color you can provide beyond 2019 in terms of FDM units going up above and beyond that 500,000 unit target will be helpful.

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

Sure. If you look at -- we're flipping through some papers real quick, just looking at kind of the 2018 run rate. Kevin, did you...

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

Yes. So if you look at the 2018 run rate, I mean, the -- you're pretty spot on as far as like kind of how much that impacted the quarter. Right now, we've talked about, in the past, kind of where we felt like we were running a little bit ahead of forecast for that 500,000 unit perspective. And Neil mentioned earlier 6 more nameplates coming online at the end of the year. And so I think this year, the run rate right now is probably close to what you talked about, but that's kind of where the acceleration starts to take hold. If launches go as according and on time, we should have no problem getting to that kind of 0.5 million unit pace in '19.

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

And probably like, I think you mentioned, Kevin, we are probably here higher than the rate you mentioned currently on that run rate.

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

Yes.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Got you. And I -- last one on FDM and a couple of others, if that's okay. The supply disruption has not delayed the gen 2 FDM product launch. I think that was the end of this year. I just wanted to confirm that.

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

That's correct. That's going...

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Great. And then the -- just switching gears quick. The new capital allocation strategy, so we knew about the $525 million cash target, but I was wondering if the leverage tolerance of Gentex may have changed under this new strategy. Or really, should we expect Gentex to be a net cash position into perpetuity? Any net cash sort of targets you can provide us with?

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

Yes, so if you look at that net cash target of $525 million, I think that's -- it's indicative of who we are as a company and our conservative approach to things. What it does state though is -- and like we showed during the HomeLink transaction, we do have tolerance for changes in that depending on the opportunity. But minus a strategic acquisition that would drive us to kind of a non-net cash positive position, you're going to see us kind of operate inside of this range of cash. What it does do is show that we are reducing pretty significantly the total amount of cash that we feel is necessary to execute the business successfully, and we're going to look to deploy that both in growing the business and then also being more aggressive on the share repurchase front.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Okay, so to be clear, the $525 million is the net cash target?

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

That's correct.

Anthony J. Deem - *Longbow Research LLC - Senior Analyst*

Okay. Got you. And then just last question for me guys. I appreciate it. On the buyback plan, so it looks like you previously disclosed $425 million for the year. I think that amounts probably around $345 million now for the remainder of the year. Just wondering the cadence of that back half weighted, second quarter big pickup or not?

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

Generally speaking -- thanks, Anthony, for the question. Generally speaking, we try to do things pretty systematically for the most part. But when you see things -- when the start moves more -- there's downward pressure on, and we tend to pick it up a little bit, so it might be a little bit. We say -- I would say 75% to 80% of it is going to be normal course $100 million, $100 million, $100 million or whatever per quarter. But then beyond that, $80 million a quarter and then the rest of it is going to be a flexible type of do more when we're down and a little bit less when we're up so that we have -- we average in, I guess, as much as we can. So you're not going to see much overweight in 1 quarter versus the next. So...

Operator

Our next question comes from David Whiston of Morningstar.

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

I guess, first, on the tax rates, can we make any inference on a long-term tax rate given the 2018 tax rate guidance? Or is it just too difficult to determine long term because of the stock option?

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

Well, I think the only variable in that -- assuming laws don't change again beyond '18, the only variability is the stock-based compensation, and that was about 1 to 1.5 percentage points in the quarter. And if you model in -- if our stock's moving, you're going to see people, employees of the company, exercise the stock options and that's when the benefit grows. This quarter was fairly large, and it still was only $1 million. But by and large, the reason for the drop in the guidance was because of further -- like we said in the press release, a little bit more analyzing of the benefits of the foreign, derived tangible income fees in our R&D tax credit that we have for the company kind of fine-tuning the forecast. And that will have some variability as we get through the year and actual sales kind of play out. But I think, again, assuming laws don't change again or the IRS doesn't interpret things completely different than our experts in us, we feel pretty good about that long-term rate.

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

And the midpoint of the range.

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

Yes.

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

And I'd point out that a lot of that work that Kevin and the tax team has done has been focused on helping improve overall our tax rate over the last several years, and that includes increased focus on R&D tax credits and the other facets of the business that Gentex, we believe, is best-in-class. And that's allowed us to obviously take advantage of this new tax law change and try to be more aggressive as it relates to our positioning on taxes.

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

And going back to the Fingerprint's announcement earlier this year, can you just talk about why you wanted them as your technology partners versus someone else?

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

Sure. When you look at -- if you look at the -- I'll give a quick answer. I know Neil is probably going to choke me for answering his question. But if you look at our research and analysis on the topic, we felt like the -- this technology partner had the most compelling technology that we are positioned correctly together. Fingerprint, historically being focused more on the mobile market, not necessarily as focused on automotive. The strategic partnership was there. We felt like the teams cohesively work together, and that there was a lot of synergy associated with how we are approaching this market from different angles. And so if you look at that big picture, we thought like the relationship and the financials and anything associated with that made sense. I think Neil probably wants to comment a little bit on the technology piece.

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

I think you're exactly right. I think the fact that the mobile experience was of great value, the user interface for this type of technology is -- can be complicated. And by going through the mobile experience, there were -- there was a lot of innovation around how to help make that as seamless as possible and easy to use. So that helped significantly in narrowing the choices.

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

Okay. And last one is for Steve. You've done some capital allocation announcements and just some promotions. Is there -- do you feel like, at this point, the -- metaphorically speaking, the airplane is mostly turned the right way? Or are there other some radical changes you want to do?

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

No, I don't think -- what's great about the way the company has been positioned and the fact that we have been -- all of the -- the 3 of us have been with Gentex, I think I'm the shortest tenured, nearly 16 years, but if you look at the influence that we've had on the organization over those years, we've -- the ship's pointed in the right direction. Now it's about speeding up or slowing down certain attributes of the company to make sure that we're maximizing opportunities. And so nothing -- there's never going to be no catastrophic changes in how we do business. In fact, most of the business philosophy that we described today is part of the culture that we've helped create. If you look at the future, what we would say is, yes, the capital allocation strategy is something that we believe make sense. If you look at the increased focus on tax efficiency, that's something that we believe in. More importantly, if you look at Neil's promotion and our increased focus on technology and helping our customers understand that we're not just a mirror technology, we're a true technology company, and that technology can play out in many form factors. This year, at CES, we wanted to show that, not just talk about it but show it to our customers, and that's why we showed so many new compelling technologies, even taking our existing technology in the form of electrochromics and turning that to a whole new series of technology platforms not tied to mirrors, look at other areas of the car, large area devices, aerospace applications and taking what the company does really well and hopefully creating a new business environment out of that.

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

Okay. And just very quickly, a point of clarification on the net cash question from the last analyst. The March 9th press release talked about total cash position, $700 million to $525 million. Should there also be language there basically saying and the net cash position of $525 million?

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

Well, right now -- I mean, in theory, we'll get to that question if there becomes a reason why we need an extended -- need access to debt for an extended period of time. Right now, we don't see that. And so when we say cash, we're talking net cash, in essence. But obviously, that's subject to change, depending on the targets that move in front of us.

Operator

Our next question comes from David Stratton of Great Lakes Review.

David Michael Stratton - *Great Lakes Review - Research Analyst*

When we look at the supply issue that you experienced, can you just kind of briefly talk about where you see your supply chain right now? And has this caused you to rethink maybe having too much one supplier or just kind of the puts and takes of what happened and whether that will drive a change to prevent this from happening again?

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

When, I think, you look strategically at how we're set up from a supply standpoint, we actually have multiple suppliers for these type of components. Obviously, each component -- in this case, each component that you get is unique to the design. So regardless of what you do, you're going to have some exposure to one supplier on very specifically engineered circuit-related products. It always makes you reevaluate -- any time this happens, it makes you reevaluate everything that you have in place to sort quality, be prepared to make sure you're looking at things, making sure our suppliers understand our expectations around performance and quality. But I mean, nothing changes from a strategic standpoint of how we source product. I mean, we look at the partners that we have. We believe in them, that they're the right suppliers. But our expectation is clear, that they need to perform perfectly because that's what our customers' expectation are of us.

David Michael Stratton - *Great Lakes Review - Research Analyst*

And then just a really quick touch on the other segment, which is, I know, a small part, but that growth is pretty significant. And I was wondering if you could kind of delineate what's driving that, and whether it's a fundamental thing that we should expect to see 30% revenue growth continue or if this is just a onetime anomaly.

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

Well, thanks for noticing. We have actually seen some improvements on the fire protection side. We've had a couple of customers that have been performing well and been growing in that segment. And currently, what we're seeing is that those customers are still nonperforming. Again, it's not moving the needle a ton on overall revenue. And then -- on the fire protection side. But then on the window side, that -- last year was kind of an anomaly from a low perspective, and so we're -- you're seeing kind of that normalization of all the platforms of the 787 kind of being online, and so better performance there from last year as well. And I would say it's probably -- until we announce further platforms on the window side, you're probably going to see that kind of steady-state revenue on that product.

David Michael Stratton - *Great Lakes Review - Research Analyst*

Great. And then since you mentioned it, are there any other platforms in the mix, or in the works, rather?

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

We continue to work through -- I think we mentioned a few quarters ago that we've been pretty active on the quote side of that type of technology. We don't have anything official that we can announce yet, but we do know that the product is sticky with the customers, and the OEMs are definitely interested in deploying this type of technology in the future.

Operator

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

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

First question, I have to follow up on the decline in the outmargins on a year-over-year basis, just to make sure I understand it. When you look at this, you said there was 2 things: fixed leverage and price downs, which are sort of normal course; and then there were missed shipments on the Full Display Mirror. So I'm just curious how much of that 200 basis points, I kind of heard 2 numbers, and I just want to make sure I have this straight, is from the missed shipments, which really are -- really kind of onetime items?

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

Yes. Like we said, that's -- sorry about the confusion there. The 30 basis points on gross margin and 40 basis points on operating margin were results of kind of the FDM issue, missed shipments and expedited freight costs and then inefficiencies in the manufacturing related to that or not, inability to manufacture during that period of time.

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

So out of the 200 basis point decline year-over-year, 70 basis points you think is exclusively because of the FDM issue, and the rest is price downs and some of these slightly different production schedules that you're expecting?

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

No, about 30 basis points is for gross margin on a year-over-year basis related to FDM.

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

And then that rolls off into a total of 40 basis points...

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

From margin.

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

From the operating margin.

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

Got it. Okay. So 40 basis points out of the 200, so you have 160 basis points of decline because of price downs and regular fixed leverage or deleveraging relative to your expectation?

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

Yes. The leverage Kevin mentioned was about 170 basis points of headwind due to the slower growth rate and the inability to leverage fixed overhead costs. So they're going to be -- the total of these are going to be more obviously than the -- the negatives are going to be more than what would get us to the center point of our guidance, and the reason for that is there were positives in the quarter as well.

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

Got you. Okay. And then when you think about those differences in production schedules relative to what you were expecting, was there anything that was unique in programs that you're highly contented on? Or was this sort of general, sort of malaise in the production schedule relative to you, what you're expecting at the beginning of the quarter?

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

If you look at -- there was definitely inside of -- I mean, it's a big -- there's a lot of regions and a lot of moving parts there. So obviously, North America, having our most exposure there, was problematic because the production wasn't -- did not perform well on a year-over-year basis, and it certainly didn't perform well against what IHS was forecasting at the end of last year for Q1. So that has a -- that always has a higher disproportionate impact on us than, say, the Japan Korea production environment. Now what's been happening as we've been growing and penetrating in both the European and Japan, Korea market is we do have more exposure there. And Japan, Korea has been pretty erratic from an overall production standpoint. And then obviously, as you're growing content in those regions, you start to have more exposure. So North America will be the single biggest impact. But if you look at our impact in Europe, there was definitely an impact from the production slowdown and definitely not -- Europe did not perform at the level that we had anticipated coming into the quarter.

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

And was -- this is broad-based market commentary as opposed to any specific heavily content to Gentex program, is that correct?

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

Absolutely, yes. Sorry. That's exactly what I meant by that, more of the underlying market than Gentex-related.

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

Got it. And then on the programs of winning Full Display Mirrors on, I'm just curious, do any of these products also have rear camera displays in another screen? Or when you're doing these FDMs, is it that exclusive screen for any kind of rear view or camera views in those vehicles?

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

Yes, the majority of them actually have separate backup camera display screen as well, especially in the North American market where it's mandated, starting -- I think it's in May here of '18 that it's required. Some of the other markets there may not be, but predominantly, all of those will have both.

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

And what's interesting about the OEM strategy as it relates to backup camera versus the technology we're providing is they're completely different use cases, and they're not mutually exclusive. Now what's exciting about what we've been showing in our Full Display Mirror execution and some OEMs are showing a lot of interest in is multiple camera feeds coming into our Full Display Mirror so that you can do split-screen applications and start to save them -- give them opportunity to either save money on backup camera solutions that just meet compliance by leveraging our Full Display Mirror location and technology platform.

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

And I'm sorry, just -- there's no reason that your Full Display Mirrors couldn't meet the Kids Safety Act requirements, right? I mean, that's just a question of which feed comes into the mirror. Is that correct?

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

Absolutely correct.

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

Yes.

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

That's all about camera location and where that camera is looking. Our mirror will absolutely meet the requirement. In fact, we can meet the requirement with our -- what we call our reverse camera display mirror, which is a very small display. We can meet the requirement with that. Our Full Display Mirror is more than adequately sized to meet all the requirements of KTSA.

Operator

Our next question comes from Ryan Brinkman of JPMorgan.

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

Firstly, can you provide an update on the competitive environment in the Full Display Mirror market? So such as from [Focosa], et cetera. I think you suggested previously that competitive products might be heavier or more expensive than your first-generation product, which is evolving. Has any Full Display Mirror competitor secured any contracts to your knowledge?

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

Like we mentioned early on as I'll kind of go back at couple of years in the history of Full Display Mirrors, there were a couple accessory programs when this -- when we kind of got our first few production awards that were in the Japan market already kind of being produced. They were, we believe, all low volume. They did not have electrochromics. We believe the mirror would -- the mirror portion when it defaulted out of a display mode would not have met the requirement for most of the region in terms of minimum requirements for reflectivity and performance. Since that time, almost all of the awards that have happened, we have now 6 OEMs, 5 that we've named, sixth one that we announced that we've been sourced with, there have been a few very small type programs that have been awarded, nothing in the North American market, nothing in the European market, just a few small programs in the Asian markets that we're aware of. I think 1 or 2 small programs with domestic OEs in China, and then I believe a couple accessory programs in the Japan market.

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

Okay. That's helpful. And then is there an update you can provide to on what might be happening to Europe relative to some vehicles there debuting with the system of cameras and displays that are not able to transition back and forth between the display and the mirror? I know that's not allowed in the U.S. What are you seeing there? And then what do you think the cost of that solution is relative to your base electrochromic, auto-dimming mirror or your Full Display Mirror?

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

Yes. So on the technology side, we believe there will be a vehicle that's coming out later this year in the European market. That's one vehicle that have come out with, I know it's called camera monitoring system with no mirrors. But honestly, after that...

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

No outside mirrors.

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

No outside mirrors. After that, it's slowed down significantly, and people pursuing that. Due to some of the issues that have been discussed and identified of camera cleanliness, some consumers can't utilize that display effectively in driving from a safety perspective. So a lot of technical challenges that are still being uncovered as this gets evaluated and tested.

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

And we believe that will be a fairly low volume execution as well. It is, we believe, optional content on that vehicle, which I think will further hamper the -- and to answer your question on economics, if you look at a 3-camera system feeding -- and this example that Neil mentioned, 2-doors mounted displays and then additional processing, you're probably talking in the range of at least $500 to $600 in cost to the OEM for that type of system. If you look at our traditional mirrors and our Tier 1 partners that provide traditional outside mirror shelves, you could accomplish that same type of raw technology, obviously without the digital aspects of it, but just a normal electrochromic mirror, you're probably looking at something in the $70 range. So it's a pretty significant cost increase to the OEM to head down this path. This is why at CES, we showed our version of a camera monitoring system, which is reducing the outside mirror size, collocating cameras behind the glass of those products and then leveraging our Full Display Mirror as the primary display location in the interior of the vehicle. It helps you come up with a more cost-effective solution, and it has the redundancy and built-in failsafe of an inside mirror so that an OEM doesn't have to have a complete retool of the vehicle in order to bring this type of technology to the marketplace.

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

I see it. Extremely helpful. Just last question. Could you please elaborate on, if you can, what components specifically there was an issue with, with regard to the Full Display Mirror that was specific to that product only? I think I heard you say. In part, I'm just trying to understand if the component has some application in autos outside of mirrors, and maybe we'll hear about this also at this earnings season.

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

Yes, it's a very specific part to that product design. It's actually the circuit board itself had some production challenges with it.

Operator

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

Josh O'Berski

That's all from us. Thank you, everyone, for your time and questions this morning. Have a great weekend.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes today's program. You may now disconnect. Everyone, have a great day.
