

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **June 30, 2018**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission File Number: **0-21810**

GENTHERM INCORPORATED

(Exact name of registrant as specified in its charter)

Michigan (State or other jurisdiction of incorporation or organization)	95-4318554 (I.R.S. Employer Identification No.)
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21680 Haggerty Road, Northville, MI (Address of principal executive offices)	48167 (Zip Code)
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Registrant's telephone number, including area code: **(248) 504-0500**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a small reporting company)	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At July 27, 2018, there were 36,462,906 issued and outstanding shares of Common Stock of the registrant.

GENTHERM INCORPORATED

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GENTHERM INCORPORATED
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 65,357	\$ 103,172
Accounts receivable, less allowance of \$1,165 and \$973, respectively	200,024	185,058
Inventory:		
Raw materials	65,686	64,175
Work in process	13,251	16,139
Finished goods	39,426	41,095
Inventory, net	118,363	121,409
Derivative financial instruments	—	213
Prepaid expenses and other assets	62,828	51,217
Total current assets	446,572	461,069
Property and equipment, net	203,949	200,294
Goodwill	68,845	69,685
Other intangible assets, net	73,574	83,286
Deferred financing costs	811	936
Deferred income tax assets	82,762	30,152
Other non-current assets	13,500	37,983
Total assets	\$ 890,013	\$ 883,405
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 95,022	\$ 89,596
Accrued liabilities	72,781	77,209
Current maturities of long-term debt	3,433	3,460
Derivative financial instruments	454	1,050
Total current liabilities	171,690	171,315
Pension benefit obligation	7,372	7,913
Other liabilities	7,422	2,747
Long-term debt, less current maturities	109,467	141,209
Deferred income tax liabilities	5,636	6,347
Total liabilities	301,587	329,531
Shareholders' equity:		
Common Stock:		
No par value; 55,000,000 shares authorized, 36,400,971 and 36,761,362 issued and outstanding at June 30, 2018 and December 31, 2017, respectively	252,740	265,048
Paid-in capital	15,838	15,625
Accumulated other comprehensive loss	(31,843)	(20,444)
Accumulated earnings	351,691	293,645
Total shareholders' equity	588,426	553,874
Total liabilities and shareholders' equity	\$ 890,013	\$ 883,405

See accompanying notes to the consolidated condensed financial statements.

GENTHERM INCORPORATED
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Product revenues	\$ 263,779	\$ 243,378	525,668	\$ 492,645
Cost of sales	189,308	165,060	372,652	329,176
Gross margin	74,471	78,318	153,016	163,469
Operating expenses:				
Net research and development expenses	21,022	21,407	44,326	40,912
Selling, general and administrative expenses	31,641	31,775	65,368	62,581
Restructuring expenses	6,215	—	7,080	—
Total operating expenses	58,878	53,182	116,774	103,493
Operating income	15,593	25,136	36,242	59,976
Interest expense	(1,240)	(1,261)	(2,420)	(2,383)
Foreign currency gain (loss)	5,174	(13,251)	596	(14,580)
Other income	215	260	1,326	505
Earnings before income tax	19,742	10,884	35,744	43,518
Income tax expense	3,083	2,371	6,119	9,603
Net income	\$ 16,659	\$ 8,513	\$ 29,625	\$ 33,915
Basic earnings per share	\$ 0.46	\$ 0.23	\$ 0.81	\$ 0.92
Diluted earnings per share	\$ 0.45	\$ 0.23	\$ 0.81	\$ 0.92
Weighted average number of shares – basic	36,523	36,777	36,560	36,699
Weighted average number of shares – diluted	36,667	36,840	36,663	36,796

See accompanying notes to the consolidated condensed financial statements.

GENTHERM INCORPORATED

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$ 16,659	\$ 8,513	29,625	\$ 33,915
Other comprehensive income (loss), gross of tax:				
Foreign currency translation adjustments (loss) gain	(22,994)	23,285	(11,253)	28,800
Unrealized (loss) gain on foreign currency derivative securities	(1,561)	815	551	3,775
Unrealized gain (loss) on commodity derivative securities	—	16	(218)	48
Other comprehensive (loss) income, gross of tax	\$ (24,555)	\$ 24,116	(10,920)	\$ 32,623
Other comprehensive income (loss), related tax effect:				
Cumulative effect of accounting change due to ASU 2018-02	—	—	(40)	—
Foreign currency translation adjustments (loss) gain	(156)	(106)	(232)	(109)
Unrealized (loss) gain on foreign currency derivative securities	419	(219)	(148)	(1,014)
Unrealized gain (loss) on commodity derivative securities	—	(6)	(59)	(17)
Other comprehensive (loss) income, related tax effect	\$ 263	\$ (331)	(479)	\$ (1,140)
Other comprehensive (loss) income, net of tax	\$ (24,292)	\$ 23,785	(11,399)	\$ 31,483
Comprehensive (loss) income	\$ (7,633)	\$ 32,298	18,226	\$ 65,398

See accompanying notes to the consolidated condensed financial statements.

GENTHERM INCORPORATED
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
Operating Activities:		
Net income	\$ 29,625	\$ 33,915
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	25,823	21,191
Deferred income taxes	(1,799)	(2,278)
Stock compensation	4,063	4,761
Defined benefit plan expense	(103)	94
Provision of doubtful accounts	204	6
Loss on sale of property and equipment	2,156	249
Changes in operating assets and liabilities:		
Accounts receivable	(17,469)	(6,949)
Inventory	1,631	1,149
Prepaid expenses and other assets	(12,094)	(5,147)
Accounts payable	10,540	(2,932)
Accrued liabilities	(10,034)	(37,944)
Net cash provided by operating activities	<u>32,543</u>	<u>6,115</u>
Investing Activities:		
Proceeds from the sale of property and equipment	698	34
Final payment for acquisition of subsidiary, net of cash acquired	(15)	(2,000)
Purchases of property and equipment	(22,138)	(25,750)
Net cash used in investing activities	<u>(21,455)</u>	<u>(27,716)</u>
Financing Activities:		
Borrowing of debt	15,000	—
Repayments of debt	(46,742)	(8,428)
Cash paid for the cancellation of restricted stock	(882)	(1,100)
Proceeds from the exercise of Common Stock options	4,966	2,061
Repurchase of Common Stock	(20,241)	(53)
Net cash used in financing activities	<u>(47,899)</u>	<u>(7,520)</u>
Foreign currency effect	(1,004)	16,111
Net decrease in cash and cash equivalents	(37,815)	(13,010)
Cash and cash equivalents at beginning of period	103,172	177,187
Cash and cash equivalents at end of period	<u>\$ 65,357</u>	<u>\$ 164,177</u>
Supplemental disclosure of cash flow information:		
Cash paid for taxes	<u>\$ 18,100</u>	<u>\$ 58,831</u>
Cash paid for interest	<u>\$ 2,608</u>	<u>\$ 2,190</u>
Supplemental disclosure of non-cash transactions:		
Common Stock issued to Board of Directors and employees	<u>\$ 2,419</u>	<u>\$ 2,229</u>

See accompanying notes to the consolidated condensed financial statements.

GENTHERM INCORPORATED
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

Note 1 – The Company and Subsequent Events

Gentherm Incorporated is a global technology and industry leader in the design, development, and manufacturing of innovative thermal management technologies. Unless the context otherwise requires, the terms “Company”, “we”, “us” and “our” used herein refer to Gentherm Incorporated and its consolidated subsidiaries. Our products provide solutions for automotive passenger comfort and convenience, battery thermal management, remote power generation, patient temperature management, environmental product testing and other consumer and industrial temperature control needs. Our automotive products can be found on the vehicles of nearly all major automotive manufacturers operating in North America, Europe and Asia. We operate in locations aligned with our major customers’ product strategies to provide locally enhanced design, integration and production capabilities and to identify future thermal technology product opportunities in both automotive and other markets. We concentrate our research on the development of new technologies and new applications from existing technologies to create product and market opportunities for a wide array of thermal management solutions.

New Strategic Plan

On June 25, 2018, Gentherm announced a new strategic plan intended to improve business performance and position the Company to deliver above-market growth and improved profitability to its shareholders. An important element of the strategy is the Fit-for-Growth initiative that focuses on purchasing excellence, rationalization of research and development activities, reducing selling, general and administrative expense, minimization or elimination of investments in non-core areas and developing a manufacturing footprint commensurate with the new plan. Non-core areas of investment so far identified under the Fit-for-Growth initiative are concentrated in the following areas of Gentherm’s industrial segment: California Advanced Research and Development, Gentherm Global Power Technologies (GPT) and Cincinnati Sub Zero’s Industrial Chamber business (CSZ-IC).

The strategy also identified several product categories the Company will exit, including furniture, aviation, battery management electronics, industrial battery packs, automotive thermoelectric generators and other non-core electronics.

Fit-for-Growth

The Fit-for-Growth cost savings initiative began in January 2018. Consultant costs associated with the initiative, some of which were incurred during the first quarter of 2018, were reported in restructuring expenses for both the three and six-month periods ended June 30, 2018. The total amount of consultant costs incurred during the six-month period ended June 30, 2018 is \$1,499. We expect to incur an additional \$840 in consultant costs during the second half of 2018.

Gentherm recognized \$1,737 in one-time employee termination costs in restructuring expenses pertaining to Fit-for-Growth during the three and six-months ended June 30, 2018. Management cannot reasonably estimate the total amount of employee termination costs expected to be incurred from implementing Fit-for-Growth. Lastly, management recognized \$11 in contract termination costs in restructuring expenses and does not anticipate additional contract termination costs in the future from implementing Fit-for-Growth.

Advanced Research and Development Rationalization and Site Consolidation

In June, Gentherm completed a sale of its battery management systems division located in Irvine, California. A loss on the sale of \$1,107 was recognized in restructuring expenses during the three and six-month periods ended June 30, 2018.

Gentherm also initiated a plan to consolidate advanced research and development operations, including the closure of two leased facilities located in Azusa, California. One of these facilities was vacated in June; the other facility is expected to be vacated at the end of the 2018 third quarter. During the three and six-month periods ended June 30, 2018, Gentherm recognized \$435 in contract termination costs in restructuring expenses related to the vacated facility, and expects to incur an additional \$537 in contract termination costs related to the second facility during the third quarter.

Gentherm recognized \$881 in one-time employee termination costs in restructuring expenses for employees whose termination was effective on or before June 30, 2018. We expect to incur \$166 in additional one-time employee termination costs for employees whose termination benefits are contingent on a continuation of service through October 2018.

GENTHERM INCORPORATED
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

Note 1 – The Company and Subsequent Events – Continued

Lastly, during the three and six-month periods ended June 30, 2018, Gentherm recognized \$1,200 in restructuring expenses for the disposal of long-lived assets controlled and used in Azusa, California. We do not expect to incur additional asset disposal costs from our exit from Azusa, California.

GPT and CSZ-IC

Gentherm is in the early stages of developing a program to identify potential buyers for GPT and CSZ-IC. For the six-month period ended June 30, 2018, Gentherm recognized \$210 in one-time employee termination costs in restructuring expenses relating to the planned divestitures. An estimate of the total cost expected from the divestitures could not be determined as of June 30, 2018.

Restructuring Liability

A reconciliation of the beginning and ending restructuring liability is as follows:

	One-Time Employee Termination Benefit Costs	Contract Termination Costs	Consulting Costs	Asset Disposal Costs	Total
Six Months Ended June 30, 2018					
Balance, beginning of period	\$ —	\$ —	\$ —	\$ —	\$ —
Additions, charged to costs	2,828	446	1,499	2,307	7,080
Payments and impairments	(1,951)	(18)	(867)	(2,307)	(5,143)
Balance, end of period	\$ 877	\$ 428	\$ 632	\$ —	\$ 1,937

The cumulative amount of restructuring expenses incurred and recognized in the automotive and industrial segments during the six months ended June 30, 2018 was \$3,247 and \$3,833, respectively. See Note 5 to our consolidated condensed financial statements for a description of our reportable segments as well as their proportional contribution to the Company's reported product revenues and operating income.

U.S. Tax Reform

The Tax Cuts and Jobs Act (the "Tax Act") was enacted on December 22, 2017. The Tax Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on all offshore earnings that were previously tax deferred and creates new taxes on certain foreign sourced earnings. As of December 31, 2017, and in accordance with guidance provided by Staff Accounting Bulletin No. 118 (SAB 118), the Company had not completed its accounting for the tax effects of the Tax Act; however, in certain cases, as described below the Company made a provisional estimate of the effects on our existing deferred tax balances and the one-time transition tax. For the year ended December 31, 2017, the provision for income taxes includes a provisional income tax expense of \$20,153 related to items for which the Company was able to determine a reasonable estimate. For the six-month period ended June 30, 2018, there have been no changes to the provisional income tax expenses booked in 2017. In all cases, we will continue to make and refine our calculations as additional analysis is completed. In addition, the Company's estimates may be affected as additional regulatory guidance is issued with respect to the Tax Act. Any adjustments to the provisional amounts will be recognized as a component of the provision for income taxes in the period in which such adjustments are determined, but in any event, no later than the fourth quarter of 2018, in accordance with SAB 118.

Deferred tax assets and liabilities

The Company remeasured its U.S. deferred tax assets and liabilities at 21%. However, the Company is still analyzing certain aspects of the Tax Act and refining the calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. In the year ended December 31, 2017, the provision for income taxes included provisional income tax expense of \$5,808 related to the remeasurement of deferred tax balances. For the six-month period ended June 30, 2018, there have been no changes to the provisional income tax expenses in 2017.

GENTHERM INCORPORATED
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

Note 1 – The Company and Subsequent Events – Continued

Transition Tax on Deferred Foreign Earnings

The one-time transition tax is based on the Company's post-1986 earnings and profits ("E&P") that were previously deferred from U.S. income taxes. In the year ended December 31, 2017, the provision for income taxes included provisional income tax expense of \$23,923 related to the one-time transition tax liability of the Company's foreign subsidiaries. The Company has not completed its calculation of the total post-1986 E&P for these foreign subsidiaries. Further, the transition tax is based in part on the amount of those earnings held in cash and other specified assets. This amount may change when the Company finalizes the calculation of post-1986 E&P previously deferred from U.S. income taxes and the amounts held in cash or other specified assets. For the six-month period ended June 30, 2018, there have been no changes to the provisional income tax expenses booked in 2017. A benefit of \$9,578 was included in the provision for income taxes for the year-ended December 31, 2017 to offset the one-time transition tax related to the previous deferred tax liability that existed for the undistributed foreign earnings that were not permanently reinvested. For the three and six-month periods ended June 30, 2018, there have been no changes to the provisional income tax benefit booked in 2017 related to this item. However, we continue to recognize a deferred tax liability related to foreign withholding tax that will be incurred for undistributed foreign earnings that are not permanently reinvested.

Subsequent Events

We have evaluated subsequent events through the date that our consolidated condensed financial statements are issued. No events have taken place that meet the definition of a subsequent event requiring adjustments to or disclosures in this Form 10-Q.

Note 2 – Basis of Presentation and New Accounting Pronouncements

Accounting Principles

Our unaudited consolidated condensed financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the audited annual consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all adjustments, consisting of normal recurring items, considered necessary for a fair presentation of our results of operations, financial position and cash flows have been included. The balance sheet as of December 31, 2017 was derived from audited annual consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Certain reclassifications of prior year's amounts have been made to conform with the current year's presentation. Notably, results from asset disposals during the six-month period ended June 30, 2017 were reclassified from other income to cost of sales. Operating results for the six-month period ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These consolidated condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017.

Consolidation

The consolidated financial statements at June 30, 2018 and December 31, 2017 and for the six-month period ended June 30, 2018 and 2017, reflect the consolidated financial position and consolidated operating results of the Company. Investments in affiliates in which Gentherm would not have control, but would have the ability to exercise significant influence over operating and financial policies, would be accounted for under the equity method. Investment for which Gentherm is not able to exercise significant influence over the investee and which do not have readily determinable fair values are accounted for under the cost method. Intercompany accounts have been eliminated in consolidation.

Use of Estimates

The presentation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates and assumptions.

GENTHERM INCORPORATED
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

Note 2 – Basis of Presentation and New Accounting Pronouncements – Continued

Revenue Recognition

Revenue is recognized from agreements containing enforceable rights and obligations when promised goods are delivered or services are completed, the price is fixed or determinable, and payment has been received or is collectable. The amount of revenue recognized is net of the Company's obligation for returns, rebates, discounts, taxes, if any, collected from customers, and consideration that is paid to a customer, unless such payment is in exchange for a distinct good or service. The amount of revenue recognized from a contract with a customer reflects the amount of consideration expected to be received in exchange for the transfer of good or services.

Automotive Revenues

The Company sells automotive seat comfort systems, specialized automotive cable systems and automotive thermal convenience products under long-term supply agreements ("LTAs") and, for arrangements that are less than one year in length, purchase orders. LTAs are multiple-year business awards to provide custom designed parts for a particular automotive vehicle program in quantities and at intervals of the customer's choosing. LTAs are often multiple-element agreements. The main element in LTAs are production parts; distinct promises from which the customer can benefit separately from other promises or elements in the contract. A second element in LTAs are production part purchase options that provide customers the ability to purchase additional parts at set prices in the future. Judgement is used to determine whether a production part purchase option represents a material right to the customer and should be accounted for as a separate performance obligation. LTAs that provide customers with a purchase option discount incrementally higher than the range discounts typically given to automotive customers contain a material right. The magnitude of change in the year-over-year option prices and the total number of units expected to be ordered are important factors in the calculation of the option's fair value and the allocation of transaction price.

The price for parts is set at the point in time the customer exercises its option to purchase additional parts from the Company. A firm order, stating the number of each production part to be delivered, is an independent contract with a discrete transaction price. Revenues are allocated to production parts based on the relative standalone selling prices observed on the LTAs. As a practical alternative to estimating the standalone selling price of an option that provides a customer with a material right, the Company allocates transaction price to options by reference to the production part volumes expected to be ordered and the consideration expected to be received. The Company satisfies its obligation to provide product parts to the customer upon shipment.

When an option to purchase additional production parts in the future represents a material right, the customer effectively is paying Gentherm in advance for production parts each time it exercises the option by placing a firm order commitment. Revenue from options containing a material right are recognized on the basis of direct measurement of the value of production parts transferred to date relative to the total number of production parts expected to be delivered over the life of the vehicle program. Judgement is required to determine the pattern and timing with which an option containing a material right is satisfied and the production part is transferred to a customer.

Industrial Revenues

Our industrial business unit generates revenue from the sale of products and services by our wholly-owned subsidiaries Cincinnati Sub-Zero ("CSZ") and GPT. Industrial business unit revenues and medical business unit revenues discussed below are reported within the Company's industrial reportable segment (see Note 5). Industrial business unit customers commonly enter into multiple-element agreements for the purchase of products and services. Installation services, for example, are separate and distinct performance obligations that are often included in contracts to purchase customized environmental test chambers. Depending on the application, delivery of an environmental test chamber or remote power generation system to the customer's place of business can range from two weeks to nine months from commencement of the contract. Installation services, while reliant on the specifications and timing from the customer, rarely remain incomplete more than two months after delivery.

GENTHERM INCORPORATED
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

Note 2 – Basis of Presentation and New Accounting Pronouncements – Continued

Revenues allocated to environmental test chambers or remote power systems are based on the stand alone selling price of products themselves. Judgement is used to determine the degree to which early pay discounts and other credits are utilized in the calculation of standalone selling price, and only included to the extent it is probable that a significant reversal of any incremental revenue will not occur. Revenues are recognized at the point in time the chamber or power system is shipped to the customer. For contracts that also include a promise for installation, the portion of total transaction price allocated to the installation is recognized as revenue at the point in time the installation is complete.

Revenues from our medical business unit are generated from the sale of products and equipment. Our medical product and equipment focus on body and blood temperature management. The Company sells medical products and equipment primarily through distributor and group purchasing organization agreements. These agreements allow member participants to the distributor or group purchasing organization to make purchases at discounted prices negotiated by the distributor or group purchasing organization. A rebate is incurred at the point in time a member participant purchases product covered under these types of agreements. Rebates are accounted for as variable consideration, using an expected value, probability weighted approach, based on the level of sales to the distributor and the time lag between the initial sale and the rebate claim in determining the transaction price of a contract. Revenue is recognized at the point in time the medical products or equipment is transferred to the customer.

Contract Balances

We record a receivable when revenue is recognized at the time of invoicing and unearned revenue when revenue is recognized subsequent to invoicing. For contracts where control of the goods or service is transferred to the customer over time, or whose terms require the customer to make milestone payments throughout the fulfillment period, the timing of revenue recognition is likely to differ from the timing of invoicing to customers.

The opening balance of our accounts receivable, net of allowance for doubtful accounts, was \$185,058 as of January 1, 2018.

We record an allowance for doubtful accounts once exposure to collection risk of an account receivable is specifically identified. We analyze the length of time an account receivable is outstanding, as well as a customer’s payment history and ability to pay to determine the need to record an allowance for doubtful accounts.

Activity in the allowance for doubtful accounts was as follows:

Six Months Ended June 30, 2018	
Balance, beginning of period	\$ 973
Additions charged to costs	615
Recoveries recognized in costs	(411)
Currency impact	\$ (12)
Balance, end of period	<u>\$ 1,165</u>

Most of Gentherm’s unearned revenue pertains to LTAs containing a material right. In the early periods of an LTA containing a material right, when payments collected from the customer are greater than the standalone selling price of the production parts, revenue associated with the material right is deferred. In future periods, when amounts collected from customers as payment is less than the standalone selling price of the production parts delivered, the deferred revenue is reversed into revenue. For LTAs containing a material right and, thus, the timing of revenue recognition is likely to differ from the timing of invoicing to customer, the aggregate amount of transaction price allocated to material rights that remain unsatisfied as of June 30, 2018 is \$2,681. We expect to recognize into revenue, 33% of this balance in the next 12 months, and the remaining 52%, 11% and 4% in 2019, 2020 and 2021, respectively.

Gentherm often requires milestone payments for contracts to provide environmental test chambers or remote power systems to customers. Milestone payments do not provide the Company with a right to payment for the work completed to date and do not represent the satisfaction of a performance obligation. Milestone payments are deferred and reported within unearned revenue until construction is complete and the unit has been delivered or is installed. If the environmental test chamber contract includes a separate promise to provide installation services, any installation-related payments received from the customer are deferred until the point in time the installation is complete.

GENTHERM INCORPORATED
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

Note 2 – Basis of Presentation and New Accounting Pronouncements – Continued

The total amount of unearned revenue associated with environmental chamber and remote power system contracts, including environmental chamber contracts that include a separate obligation to provide installation, as of June 30, 2018 is \$3,087. This entire balance is expected to be recognized into revenue during the next 12 months.

See Note 10 for information regarding the unearned revenue associated with these arrangements, including unearned revenue by segment and amounts recognized into revenue during the most recent six-month period ending June 30, 2018.

Payment terms for contracts with customers generally range from 30 to 120 days from the date of shipment of goods or completion of service or, if applicable, the scheduled milestone payment due date, and do not include components designed to provide customers with financing.

Assets Recognized from the Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if the benefits of those costs are expected to be realized for a period greater than one year. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in prepaid expenses and other assets and other non-current assets.

Recently Adopted Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the FASB issued Accounting Standard Update (“ASU”) 2014-09, “Revenue from Contracts with Customers.” ASU 2014-09 was developed to enable financial statement users a better understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update’s core principal is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those good or services. Issuers are to use a five-step contract review model to ensure revenue is measured, recognized, and disclosed in accordance with this principle. The FASB issued several amendments to the update, including a one-year deferral of the original effective date, and new methods for identifying performance obligations that are intended to reduce the cost and complexity of compliance.

We adopted ASU 2014-09 and related amendments effective January 1, 2018 using the cumulative catch-up transition method, which required us to disclose the cumulative effect of initially applying the update recognized at the date of initial application. We elected to apply the guidance in ASU 2014-09 to contracts that were not completed at January 1, 2018.

The most significant impact from adoption of ASU 2014-09 occurred within our Automotive segment and relates to our accounting for production part purchase options that grant customers a material right to purchase additional parts under long-term supply agreements in the future. Due to the complexity of certain of our automotive supply contracts, the actual revenue recognition treatment for customer purchase options will depend on contract-specific terms and could vary from other contracts that are similar in nature. Revenue recognition related to goods and services reported in the Industrial segment remains substantially unchanged.

The amount by which each financial statement line item was affected by application of ASU 2014-09 and related amendments during the three and six-month periods ended June 30, 2018 is as follows:

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Note 2 – Basis of Presentation and New Accounting Pronouncements – Continued

	Revenue Based on Previously Effective Guidance	New Revenue Standard Adjustment	Revenue Based on New Revenue Standard
Three Months Ended June 30, 2018			
Product revenues	\$ 263,058	\$ 721	\$ 263,779
Income tax expense	3,232	(149)	3,083
Net income	16,087	572	16,659
Basic earnings per share	0.44	0.02	0.46
Diluted earnings per share	0.44	0.02	0.45
Six Months Ended June 30, 2018			
Product revenues	\$ 524,267	\$ 1,401	\$ 525,668
Income tax expense	6,409	(290)	6,119
Net income	28,514	1,111	29,625
Basic earnings per share	0.78	0.03	0.81
Diluted earnings per share	0.78	0.03	0.81

	Revenue Based on Previously Effective Guidance	New Revenue Standard Adjustment	Revenue Based on New Revenue Standard
Balance Sheet June 30, 2018			
Accounts receivable, net of allowance for doubtful accounts	\$ 200,024	\$ —	\$ 200,024
Accrued liabilities	\$ 70,100	\$ 2,681	\$ 72,781
Unearned Revenue	\$ 3,087	\$ 2,681	\$ 5,768
Deferred income taxes, net	\$ 76,578	\$ 548	\$ 77,126
Accumulated earnings	\$ 353,824	\$ (2,133)	\$ 351,691

Adoption of ASU 2014-09 and related amendments had no impact to cash from or used in operating, investing or financing activities on our consolidated condensed statements of cash flows.

Statement of Cash Flows

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” ASU 2016-15 provides guidance on the classification of eight specific cash receipt and cash payment transactions in the statement of cash flows. The Company focused its evaluation on the following transactions to determine the effect ASU 2016-15 will have on the Company’s Consolidated Statements of Cash Flows:

- 1) Debt extinguishment payments and debt prepayments are to be shown as cash outflows for financing activities. Presently, Gentherm classifies debt extinguishment payments within operating activities.
- 2) Payments made to settle contingent consideration liabilities not made soon after the acquisition date of a business combination should be recognized as cash outflows for financing activities up to the amount of the liability recognized at the acquisition date. Payments, or the portion of a payment, to settle contingent consideration liabilities that exceed the amount of the liability recognized at the acquisition date will be recognized as cash outflows for operating activities.
- 3) Cash receipts from the settlement of insurance claims, excluding those related to corporate-owned life insurance policies shall be classified on the basis of the related insurance coverage. For example, proceeds received to cover claims issued under product recall liability insurance would be classified as cash inflows from operating activities.
- 4) Cash receipts from the settlement of corporate-owned life insurance policies shall be classified as cash inflows from investing activities.

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Note 2 – Basis of Presentation and New Accounting Pronouncements – Continued

We have adopted ASU 2016-15 and related amendments effective January 1, 2018. None of the cash receipt and cash payment transactions addressed by the update, including those that were not the focus of management’s evaluation, occurred during any of the periods presented in this report. Adoption of this update and related amendments did not have a material impact on the cash flows of the Company.

Income Taxes

In October 2016, the FASB issued ASU 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory.” ASU 2016-16 modifies the current prohibition to recognize deferred income taxes from differences between the tax basis of assets in the buyer’s tax jurisdiction and their cost resulting from an intra-entity transfer from one tax-paying component to another tax-paying component of the same consolidated group. Under current GAAP, deferred income taxes for intra-entity asset transfers are not recognized until the asset is sold to an outside party. ASU 2016-16 allows entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs.

ASU 2016-16 is effective for fiscal years and interim periods beginning after December 15, 2017. The amendments in ASU 2016-16 should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to accumulated earnings as of the beginning of the period of adoption. We adopted ASU 2016-16 and related amendments effective January 1, 2018 on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of such adoption date. As a result of the amendments in ASU 2016-16, a favorable adjustment of \$31,645 was recorded directly to retained earnings during the six-month period ending June 30, 2018. The new deferred tax assets will be recognized ratably over the useful life the applicable assets.

Accumulated Other Comprehensive Income

In February 2018, the FASB issued ASU 2018-02, “Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU 2018-02 provides a remedy to a narrow-scope financial reporting issue created by the Tax Act. The Tax Act required entities to adjust deferred tax assets and liabilities to reflect the impact from newly enacted lower corporate income tax rates, and recognize the effect in income from continuing operations. This requirement applied to all deferred tax assets and liabilities, even those which arose from transactions originally recognized in other comprehensive income. The amendments in ASU 2018-02 allow adjustments to deferred tax assets and liabilities due to newly enacted lower corporate income tax rates to be recognized in retained earnings, if those deferred tax balances arose from transactions originally recognized in other comprehensive income.

Income tax effects are released from accumulated other comprehensive income and recorded against the deferred tax balance in the consolidated balance sheet when the underlying activity is realized.

ASU 2018-02 is effective for annual and interim periods beginning after December 15, 2018. Early adoption of the amendments in this update is permitted, including adoption in any interim period for which financial statements have not yet been issued. The amendments in ASU 2018-02 must be applied in the period of adoption or retrospectively to each period in which the effect of the change in U.S. federal corporate income tax rate in the Tax Act is recognized. We elected to early adopt ASU 2018-02 and related amendments effective January 1, 2018. An adjustment of \$40 was recognized against retained earnings for effect of the change in the federal corporate income tax rate on deferred tax amounts. There are no related adjustments to the Company’s valuation allowance and no other income tax effects from the Tax Act on balances that remain in accumulated other comprehensive income were reclassified.

Tax Act

In January 2018, the FASB released guidance on the accounting for tax on the global intangible low-taxed income (“GILTI”) provisions of the Tax Act. The GILTI provisions impose a tax on foreign income in excess of deemed return on tangible assets of foreign corporations. During the first quarter of 2018, the Company elected to treat any potential GILTI inclusions as a period cost.

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Note 2 – Basis of Presentation and New Accounting Pronouncements – Continued

Recently Issued Accounting Pronouncements Not Yet Adopted

Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” ASU 2017-04 modified the concept of impairment of goodwill to be a condition that exists when the carrying value of a reporting unit that includes goodwill exceeds its fair value. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value, limited to the total amount of goodwill allocated to that reporting unit. Entities no longer will determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if the reporting unit had been acquired in a business combination.

ASU 2017-04 is effective for annual and any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption of the amendments in this update is permitted. The amendments in ASU 2017-04 must be applied on a prospective basis and in the initial period of adoption, entities must disclose the nature of and reason for the change in accounting principle. The Company expects adoption of ASU 2017-04 will reduce the complexity of evaluating goodwill for impairment.

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 requires lessees to recognize on their balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. Payments to be made in optional periods should be included in the measurement of lease assets and liabilities if the lessee is reasonably certain it will exercise an option to extend the lease or not exercise an option to terminate the lease. While ASU 2016-02 continues to differentiate between finance or capital leases and operating leases, the principal change from current lease accounting guidance is that lease assets and liabilities arising from operating leases will be recognized on the balance sheet.

ASU 2016-02 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption of the amendments in this update are permitted. Lessees are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach which includes a number of practical expedients, including the ability to use hindsight in evaluating lessee options to extend or terminate a lease. An entity that elects to apply the practical expedients will be required to recognize a right-of-use asset and lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payment that were tracked and disclosed under previous GAAP. We are currently in the process of determining the impact the implementation of ASU 2016-02 will have on the Company’s financial statements.

Note 3 — Etratech Acquisition

Etratech designs, develops, manufactures and sells electronic control modules and control systems to customers across a range of industries, including automotive, recreational vehicles and marine, HVAC systems and medical, amongst others. Each function is part of an integrated, customer-focused process designed to exceed customer expectations for product quality, reliability and cost. Etratech’s global manufacturing footprint will enable us to provide customers with scalable and flexible manufacturing solutions across a variety of application and geographies.

Results of operations for Etratech are included in the Company’s consolidated condensed financial statements beginning November 1, 2017. Etratech contributed \$15,201 and \$30,389 in product revenues and \$678 and \$426 in net income for the three and six-month periods ended June 30, 2018, respectively.

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Note 3 – Etratech Acquisition – Continued

Purchase Price Allocation

The purchase price of \$65,009, net of cash acquired of \$670, has been allocated to the values of assets acquired and liabilities assumed as of November 1, 2017. The purchase price allocation was finalized March 31, 2018. The purchase price allocation as of November 1, 2017 was as follows:

Accounts receivable	\$	12,654
Inventory		7,014
Prepaid expenses and other assets		535
Property and equipment		6,205
Customer relationships		24,774
Technology		8,588
Goodwill		14,881
Assumed liabilities		(9,642)
Net assets acquired		<u>65,009</u>
Cash acquired		670
Purchase price	\$	<u><u>65,679</u></u>

The gross contractual amount due of accounts receivable is \$12,654, all of which is expected to be collectible.

Supplemental Pro Forma Information

The unaudited pro forma combined historical results including the amounts of Etratech revenue and earnings that would have been included in the Company's consolidated statements of income had the acquisition date been January 1, 2017 is as follows:

	<u>Three Months Ended</u> <u>June 30,</u> <u>2017</u>	<u>Six Months Ended</u> <u>June 30,</u> <u>2017</u>
Product revenues	\$ 257,526	\$ 519,476
Net income	\$ 9,072	\$ 34,846
Basic earnings per share	\$ 0.25	\$ 0.95
Diluted earnings per share	\$ 0.25	\$ 0.95

The pro forma information includes adjustments for the effect of the amortization of intangible assets recognized in the acquisition. This pro forma information is not indicative of future operating results.

Goodwill

We recorded goodwill of approximately \$14,881 arising from the acquisition. The acquired goodwill represents intangible assets that do not qualify for separate recognition. It is estimated that approximately \$8,651 of the goodwill recognized will not be deductible for income tax purposes.

Intangible Assets

In conjunction with the acquisition, intangible assets of \$33,362 were recorded. The Company's estimate of the fair value of these assets at the time of the acquisition was determined with the assistance of an independent third-party valuation firm. As part of the estimated valuation, an estimated useful life for the assets was determined.

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Note 3 – Etratech Acquisition – Continued

Intangible assets, net consisted of the following (balances are lower as of June 30, 2018 than as of November 1, 2017, the acquisition date, due to fluctuations in foreign currency exchange rates totaling \$1,027):

	June 30, 2018			Useful Life
	Gross Value	Accumulated Amortization	Net Value	
Customer relationships	\$ 24,006	\$ 1,378	\$ 22,628	8 -12 yrs
Technology	8,329	1,084	7,245	5 -6 yrs
Total	\$ 32,335	\$ 2,462	\$ 29,873	

Amortization expenses of \$889 and \$1,847 during the three and six months ended June 30, 2018, respectively, were recognized in our consolidated condensed statement of income as follows:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
Product revenues	\$	498	\$	1,034
Cost of sales		391		813

Amortization expense for the prospective five years is expected to be as follows:

July 1, 2018 through December 31, 2018	\$	1,844
2019	\$	3,688
2020	\$	3,688
2021	\$	3,627
2022	\$	3,208
2023	\$	2,546

Property, Plant & Equipment

Property and equipment consist of the following:

Asset category	Useful life	Amount
Leasehold improvements	10 yrs	\$ 342
Machinery and equipment	4-11 yrs	5,248
Furniture and fittings	4 yrs	230
Motor vehicles	3 yrs	25
Computer hardware and software	1 yrs	360
		<u>\$ 6,205</u>

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Note 4 – Earnings Per Share

Basic earnings per share are computed by dividing net income by the weighted average number of shares of stock outstanding during the period. The Company's diluted earnings per share give effect to all potential Common Stock outstanding during a period that do not have an anti-dilutive impact to the calculation. In computing the diluted earnings per share, the treasury stock method is used in determining the number of shares assumed to be issued from the exercise of Common Stock equivalents.

The following summarizes the Common Stock included in the basic and diluted shares, as disclosed on the face of the consolidated condensed statements of income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Weighted average number of shares for calculation of basic EPS	36,523,742	36,776,545	36,560,193	36,698,618
Stock options under equity incentive plans	143,257	63,826	103,033	97,550
Weighted average number of shares for calculation of diluted EPS	<u>36,666,999</u>	<u>36,840,371</u>	<u>36,663,226</u>	<u>36,796,168</u>

The following table represents Common Stock issuable upon the exercise of certain stock options that have been excluded from the diluted earnings calculation because the effect of their inclusion would be anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Stock options under equity incentive plans	<u>1,530,000</u>	<u>1,857,284</u>	<u>1,742,500</u>	<u>1,857,284</u>

Note 5 – Segment Reporting

Segment information is used by management for making strategic operating decisions for the Company. Management evaluates the performance of the Company's segments based primarily on operating income or loss. As discussed in Note 3, Gentherm acquired Etratech on November 1, 2017.

The Company's reportable segments are as follows:

- *Automotive* – this segment represents the design, development, manufacturing and sales of automotive seat comfort systems, specialized automotive cable systems and certain automotive and non-automotive thermal convenience products. All of our activities with respect to electronics are also included in our Automotive segment because the majority of these activities relate to the manufacture of electronic components for our automotive products or the automotive products of third parties. Etratech's operating results are included within Gentherm's Automotive segment due to the concentration of Etratech's product applications within the automotive, recreational vehicle and marine industries.
- *Industrial* – the combined operating results of GPT, CSZ and Gentherm's advanced research and development division. Advanced research and development includes efforts focused on improving the efficiency of thermoelectric technologies and advanced heating wire technology as well as other applications. Unlike research and development that relates to a specific program application for a customer, advanced research and development activities affect products and technologies that are not currently generating product revenue. The segment includes government sponsored research projects.
- *Reconciling Items* – include corporate selling, general and administrative costs and acquisition transaction costs.

The tables below present segment information about the reported product revenues, depreciation and amortization and operating income (loss) of the Company for three and six-month periods ended June 30, 2018 and 2017. With the exception of goodwill, asset information by segment is not reported since the Company does not manage assets at a segment level. As of June 30, 2018, goodwill assigned to our Automotive and Industrial segments were \$38,072 and \$30,773, respectively. As of June 30, 2017, goodwill assigned to our Automotive and Industrial segments were \$22,724 and \$30,773, respectively.

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Note 5 – Segment Reporting – Continued

<u>Three Months Ended June 30,</u>	<u>Automotive</u>	<u>Industrial</u>	<u>Reconciling Items</u>	<u>Consolidated Total</u>
2018:				
Product revenues	\$ 240,823	\$ 22,956	\$ —	\$ 263,779
Depreciation and amortization	10,970	1,301	660	12,931
Restructuring expenses	2,529	3,686	—	6,215
Operating income (loss)	37,240	(7,881)	(13,766)	15,593
2017:				
Product revenues	\$ 215,812	\$ 27,566	\$ —	\$ 243,378
Depreciation and amortization	9,048	1,288	663	10,999
Operating income (loss)	40,066	(2,719)	(12,211)	25,136

<u>Six Months Ended June 30,</u>	<u>Automotive</u>	<u>Industrial</u>	<u>Reconciling Items</u>	<u>Consolidated Total</u>
2018:				
Product revenues	\$ 480,842	\$ 44,826	\$ —	\$ 525,668
Depreciation and amortization	21,779	2,652	1,392	25,823
Restructuring expenses	3,247	3,833	—	7,080
Operating income (loss)	78,404	(14,561)	(27,601)	36,242
2017:				
Product revenues	\$ 437,645	\$ 55,000	\$ —	\$ 492,645
Depreciation and amortization	17,179	2,706	1,306	21,191
Operating income (loss)	90,743	(5,134)	(25,633)	59,976

Total product revenues information by geographic area is as follows:

	<u>Three Months Ended June 30,</u>			
	<u>2018</u>		<u>2017</u>	
United States	\$ 123,512	47%	\$ 114,141	47%
China	24,927	9%	19,962	8%
Germany	23,626	9%	17,694	7%
South Korea	15,783	6%	17,754	7%
Japan	13,275	5%	13,093	5%
Canada	12,590	5%	11,113	5%
Czech Republic	11,106	4%	9,944	4%
United Kingdom	8,467	3%	8,439	4%
Mexico	4,848	2%	5,322	2%
Other	25,645	10%	25,916	11%
Total Non-U.S.	140,267	53%	129,237	53%
	<u>\$ 263,779</u>	<u>100%</u>	<u>\$ 243,378</u>	<u>100%</u>

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Note 5 – Segment Reporting – Continued

	Six Months Ended June 30,			
	2018		2017	
United States	\$ 243,862	46%	\$ 233,664	47%
China	49,131	9%	40,427	8%
Germany	45,988	9%	35,562	7%
South Korea	29,605	6%	34,145	7%
Japan	26,848	5%	27,376	6%
Canada	25,703	5%	22,042	5%
Czech Republic	22,821	4%	20,651	4%
United Kingdom	19,312	4%	18,107	4%
Mexico	11,146	2%	10,692	2%
Other	51,252	10%	49,979	10%
Total Non-U.S.	281,806	54%	258,981	53%
	<u>\$ 525,668</u>	<u>100%</u>	<u>\$ 492,645</u>	<u>100%</u>

Note 6 – Debt

Amended Credit Agreement

The Company, together with certain direct and indirect subsidiaries, have an outstanding credit agreement (as amended, the “Credit Agreement”) with a consortium of lenders and Bank of America, N.A., as administrative agent. The Credit Agreement provides the Company a revolving credit note (“U.S. Revolving Note”) with a maximum borrowing capacity of \$350,000.

All subsidiary borrowers and guarantors participating in the Credit Agreement have entered into a related pledge and security agreement. The security agreement grants a security interest to the lenders in substantially all of the personal property of subsidiaries designated as borrowers to secure their respective obligations under the Credit Agreement, including the stock and membership interests of specified subsidiaries (limited to 66% of the stock in the case of certain non-US subsidiaries). The Credit Agreement restricts the amount of dividend payments the Company can make to shareholders.

The Credit Agreement requires the Company to maintain a minimum Consolidated Interest Coverage Ratio and Consolidated Leverage Ratio. Definitions for these financial ratios are provided in the Credit Agreement.

Under the Credit Agreement, U.S. Dollar denominated loans bear interest at either a base rate (“Base Rate Loans”) or Eurocurrency rate (“Eurocurrency Rate Loans”), plus a margin (“Applicable Rate”). The rate for Base Rate Loans is equal to the highest of the Federal Funds Rate (1.91% at June 30, 2018) plus 0.50%, Bank of America’s prime rate (5.0% at June 30, 2018), or a one-month Eurocurrency rate (0.00% at June 30, 2018) plus 1.00%. The rate for Eurocurrency Rate Loans denominated in U.S. Dollars is equal to the London Interbank Offered Rate (2.09% at June 30, 2018). All loans denominated in a currency other than the U.S. Dollar must be Eurocurrency Rate Loans. Interest is payable at least quarterly.

The Applicable Rate varies based on the Consolidated Leverage Ratio reported by the Company. As long as the Company is not in default of the terms and conditions of the Credit Agreement, the lowest and highest possible Applicable Rate is 1.25% and 2.00%, respectively, for Eurocurrency Rate Loans and 0.25% and 1.00%, respectively, for Base Rate Loans.

The Company also has two fixed interest rate loans with the German Investment Corporation (“DEG”), a subsidiary of KfW Banking Group, a Germany government-owned development bank:

DEG China Loan

The first DEG loan, a loan we used to fund capital investments in China (the “DEG China Loan”), is subject to semi-annual principal payments that began March, 2015 and will end September, 2019. Under the terms of the DEG China Loan, the Company must maintain a minimum Debt-to-Equity Ratio, Current Ratio and Debt Service Coverage Ratio, as defined by the DEG China Loan agreement, based on the financial statements of Gentherm’s wholly owned subsidiary, Gentherm Automotive Systems (China) Ltd.

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Note 6 – Debt – Continued

DEG Vietnam Loan

The Company's second fixed interest rate loan agreement with DEG was used to finance the construction and set up of the Vietnam production facility ("DEG Vietnam Loan"). The DEG Vietnam Loan is subject to semi-annual principal payments that began November, 2017 and will end May, 2023. Under the terms of the DEG Vietnam Loan, the Company must maintain a minimum Current Ratio, Equity Ratio and Enhanced Equity Ratio, as defined by the DEG Vietnam Loan agreement, based on the financial statements of Gentherm's wholly owned subsidiary, Gentherm Vietnam Co. Ltd.

Undrawn borrowing capacity under the U.S. Revolving Note was \$250,934 as of June 30, 2018. The following table summarizes the Company's debt at June 30, 2018 and at December 31, 2017.

	June 30, 2018		December 31, 2017	
	Interest Rate	Principal Balance	Principal Balance	
Credit Agreement:				
Revolving Note (U.S. Dollar Denominations)	3.59%	\$ 99,000	\$	129,000
DEG China Loan	4.25%	1,400		1,919
DEG Vietnam Loan	5.21%	12,500		13,750
Total debt		112,900		144,669
Current portion		(3,433)		(3,460)
Long-term debt, less current maturities		<u>\$ 109,467</u>	<u>\$</u>	<u>141,209</u>

The scheduled principal maturities of our debt as of June 30, 2018 are as follows:

Year	Revolving Note (U.S. Dollar)	DEG China Note	DEG Vietnam Note	Total
Remainder of 2018	\$ —	\$ 467	\$ 1,250	\$ 1,717
2019	—	933	2,500	3,433
2020	—	—	2,500	2,500
2021	99,000	—	2,500	101,500
2022	—	—	2,500	2,500
2023	—	—	1,250	1,250
Total	<u>\$ 99,000</u>	<u>\$ 1,400</u>	<u>\$ 12,500</u>	<u>\$ 112,900</u>

Principal outstanding under the U.S. Revolving Note will be due and payable in full on March 17, 2021. As of June 30, 2018, we were in compliance, in all material respects, with all terms as outlined in the Credit Agreement, DEG China Loan and DEG Vietnam Loan.

Note 7 – Derivative Financial Instruments

We are exposed to market risk from changes in foreign currency exchange rates, short-term interest rates and price fluctuations of certain material commodities such as copper. Market risks for changes in interest rates relate primarily to our debt obligations under our Credit Agreement. Foreign currency exchange risks are attributable to sales to foreign customers and purchases from foreign suppliers not denominated in the location's functional currency, foreign plant operations, intercompany indebtedness, intercompany investments and include exposures to the European Euro, Mexican Peso, Canadian Dollar, Hungarian Forint, Macedonian Denar, Ukrainian Hryvnia, Japanese Yen, Chinese Renminbi, Korean Won and Vietnamese Dong.

The Company regularly enters into derivative contracts with the objective of managing its financial and operational exposure arising from these risks by offsetting gains and losses on the underlying exposures with gains and losses on the financial instruments used to hedge them. The maximum length of time over which we hedge our exposure to foreign currency exchange risks is one year. We had foreign currency derivative contracts with a notional value of \$22,397 and \$29,273 outstanding as of June 30, 2018 and December 31, 2017, respectively.

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Note 7 – Derivative Financial Instruments – Continued

The maximum length of time over which we hedge our exposure to price fluctuations in material commodities is two years. We had copper commodity swap contracts with a notional value of \$0 and \$404 outstanding at June 30, 2018 and December 31, 2017, respectively.

We do not enter into derivative financial instrument arrangements for speculative or trading purposes. Our hedging relationships are formally documented at the inception of the hedge, and hedges must be highly effective in offsetting changes to future cash flows on hedged transactions both at the inception of a hedge and on an ongoing basis to be designated for hedge accounting treatment. For derivative contracts which can be classified as a cash flow hedge, the effective portion of the change in the fair value of the derivative is recorded to accumulated other comprehensive income (loss) in the consolidated condensed balance sheet. When the underlying hedge transaction is realized, the gain or loss included in accumulated other comprehensive income (loss) is recorded in earnings in the consolidated condensed statements of income on the same line as the gain or loss on the hedged item attributable to the hedged risk. We record the ineffective portion of foreign currency hedging instruments, if any, to foreign currency gain (loss) in the consolidated condensed statements of income. See Note 9 for unrealized gains (losses) associated with derivatives reported in accumulated other comprehensive income as of December 31, 2017 that was reclassified into earnings during 2018. Though we continuously monitor the hedging program, derivative positions and hedging strategies, foreign currency forward exchange agreements have not always been designated as hedging instruments for accounting purposes.

The Company uses an income approach to value derivative instruments, analyzing quoted market prices to calculate the forward values and then discounts such forward values to the present value using benchmark rates at commonly quoted intervals for the instrument's full term.

Information related to the recurring fair value measurement of derivative instruments in our consolidated condensed balance sheet as of June 30, 2018 is as follows:

	Hedge Designation	Fair Value Hierarchy	Asset Derivatives		Liability Derivatives		Net Asset/ (Liabilities)
			Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	
Foreign currency derivatives	Cash flow hedge	Level 2	Current assets	\$ —	Current liabilities	\$ (454)	\$ (454)

Information relating to the effect of derivative instruments on our consolidated condensed statements of income is as follows:

	Location	Three Months Ended	Three Months Ended	Six Months Ended	Six Months Ended
		June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Foreign currency derivatives	Cost of sales	\$ (524)	\$ 351	\$ (605)	\$ (121)
	Selling, general and administrative	22	—	75	(216)
	Other comprehensive income	(1,561)	815	551	3,775
	Foreign currency (loss) gain	10	(20)	47	(77)
Total foreign currency derivatives		\$ (2,053)	\$ 1,146	68	\$ 3,361
Commodity derivatives	Cost of sales	\$ —	\$ 10	145	\$ 29
	Other comprehensive income	—	16	(218)	48
Total commodity derivatives		\$ —	\$ 26	(73)	\$ 77

We did not incur any hedge ineffectiveness during the three and six-month periods ended June 30, 2018 and 2017.

Note 8 – Fair Value Measurement

The Company bases fair value on a price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We have adopted a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

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Note 8 – Fair Value Measurement – Continued

Level 2: Inputs, other than quoted market prices included in Level 1, that are observable either directly or indirectly for the asset or liability.

Level 3: Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and also considers counterparty credit risk in its assessment of fair value.

Except for derivative instruments (see Note 7), pension liabilities, pension plan assets and a corporate owned life insurance policy, the Company had no material financial assets and liabilities that are carried at fair value at June 30, 2018 and December 31, 2017. The carrying amounts of financial instruments comprising cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to the relatively short maturity of such instruments. The Company uses an income valuation technique to measure the fair values of its debt instruments by converting amounts of future cash flows to a single present value amount using rates based on current market expectations (Level 2 inputs).

As of June 30, 2018 and December 31, 2017, the carrying values of the Credit Agreement indebtedness were not materially different than their estimated fair values because the interest rates on variable rate debt approximated rates currently available to the Company (see Note 6). Discount rates used to measure the fair value of the DEG Vietnam Loan and DEG China Loan are based on quoted swap rates. As of June 30, 2018, the carrying values of the DEG Vietnam Loan and DEG China Loan was \$12,500 and \$1,400, respectively, as compared to an estimated fair value of \$12,200 and \$1,400, respectively. As of December 31, 2017, the carrying value of the DEG Vietnam Loan and DEG China Loan was \$13,750 and \$1,919, respectively, as compared to an estimated fair value of \$13,600 and \$2,000, respectively.

Certain Company assets are required to be recorded at fair value on a non-recurring basis when events and circumstances indicate that the carrying value may not be recoverable. As of June 30, 2018 and December 31, 2017, the Company did not realize any changes to the fair value of these assets due to the non-occurrence of events or circumstances that could negatively impact their recoverability.

Note 9 – Reclassifications Out of Accumulated Other Comprehensive Income (Loss)

Reclassification adjustments and other activities impacting accumulated other comprehensive income (loss) during the three and six-month periods ended June 30, 2018 and June 30, 2017 are as follows:

	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Foreign Currency Hedge Derivatives	Total
Balance at March 31, 2018	\$ (2,406)	\$ (5,890)	\$ 745	\$ (7,551)
Other comprehensive income (loss) before reclassifications	—	(22,994)	(1,392)	(24,386)
Income tax effect of other comprehensive income before reclassifications	—	(156)	374	218
Amounts reclassified from accumulated other comprehensive income into net income (loss)	—	—	(169) ^a	(169)
Income taxes reclassified into net income (loss)	—	—	45	45
Net current period other comprehensive income (loss)	—	(23,150)	(1,142)	(24,292)
Balance at June 30, 2018	<u>\$ (2,406)</u>	<u>\$ (29,040)</u>	<u>\$ (397)</u>	<u>\$ (31,843)</u>

(a) The amounts reclassified from accumulated other comprehensive income (loss) are included in cost of sales.

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Note 9 – Reclassifications Out of Accumulated Other Comprehensive Income (Loss) – Continued

	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Commodity Hedge Derivatives	Foreign Currency Hedge Derivatives	Total
Balance at March 31, 2017	\$ (2,550)	\$ (60,250)	\$ 262	\$ 1,145	\$ (61,393)
Other comprehensive income (loss) before reclassifications	—	23,285	28	1,092	24,405
Income tax effect of other comprehensive income (loss) before reclassifications	—	(106)	(10)	(293)	(409)
Amounts reclassified from accumulated other comprehensive (income) loss into net income	—	—	(12) ^a	(277) ^a	(289)
Income taxes reclassified into net income	—	—	4	74	78
Net current period other comprehensive income	—	23,179	10	596	23,785
Balance at June 30, 2017	<u>\$ (2,550)</u>	<u>\$ (37,071)</u>	<u>\$ 272</u>	<u>\$ 1,741</u>	<u>\$ (37,608)</u>

(a) The amounts reclassified from accumulated other comprehensive income (loss) are included in cost of sales.

	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Commodity Hedge Derivatives	Foreign Currency Hedge Derivatives	Total
Balance at December 31, 2017	\$ (2,366)	\$ (17,555)	\$ 277	\$ (800)	\$ (20,444)
Cumulative effect of accounting change due to adoption of ASU 2018-02	(40)	—	—	—	(40)
Other comprehensive income (loss) before reclassifications	—	(11,253)	—	462	(10,791)
Income tax effect of other comprehensive income before reclassifications	—	(232)	—	(124)	(356)
Amounts reclassified from accumulated other comprehensive income into net income (loss)	—	—	(218) ^a	89 ^a	(129)
Income taxes reclassified into net income (loss)	—	—	(59)	(24)	(83)
Net current period other comprehensive income (loss)	(40)	(11,485)	(277)	403	(11,399)
Balance at June 30, 2018	<u>\$ (2,406)</u>	<u>\$ (29,040)</u>	<u>\$ —</u>	<u>\$ (397)</u>	<u>\$ (31,843)</u>

(a) The amounts reclassified from accumulated other comprehensive income (loss) are included in cost of sales.

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(In thousands, except share and per share data)
(Unaudited)

Note 9 – Reclassifications Out of Accumulated Other Comprehensive Income (Loss) – Continued

	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Commodity Hedge Derivatives	Foreign Currency Hedge Derivatives	Total
Balance at December 31, 2016	\$ (2,550)	\$ (65,762)	\$ 241	\$ (1,020)	\$ (69,091)
Other comprehensive income (loss) before reclassifications	—	28,800	78	2,965	31,843
Income tax effect of other comprehensive income before reclassifications	—	(109)	(28)	(796)	(933)
Amounts reclassified from accumulated other comprehensive income into net income (loss)	—	—	(30) ^a	810 ^a	780
Income taxes reclassified into net income (loss)	—	—	11	(218)	(207)
Net current period other comprehensive income (loss)	—	28,691	31	2,761	31,483
Balance at June 30, 2017	<u>\$ (2,550)</u>	<u>\$ (37,071)</u>	<u>\$ 272</u>	<u>\$ 1,741</u>	<u>\$ (37,608)</u>

(a) The amounts reclassified from accumulated other comprehensive income (loss) are included in cost of sales.

We expect all of the existing gains and losses related to foreign currency derivatives and commodity derivatives reported in accumulated other comprehensive income as of June 30, 2018 to be reclassified into earnings during the next twelve months. See Note 7 for additional information about derivative financial instruments and the effects from reclassification to net income.

Note 10 – Unearned Revenue

Unearned revenue by segment was as follows:

	June 30, 2018	December 31, 2017
Automotive	\$ 2,681	\$ —
Industrial	3,087	4,889
Total	<u>\$ 5,768</u>	<u>\$ 4,889</u>

Changes in unearned revenue were as follows:

Six Months Ended June 30, 2018	
Balance, beginning of period	\$ 4,889
Additions to unearned revenue	10,456
Reclassified to revenue	(9,551)
Currency Impacts	(26)
Balance, end of period	<u>\$ 5,768</u>

Revenue allocated to remaining performance obligations represent contracted revenue that has not yet been recognized, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods.

Forward-Looking Statements

This Report contains forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent our goals, beliefs, plans and expectations about our prospects for the future and other future events, such as our ability to execute our new strategic plan, our ability to finance sufficient working capital, the amount of availability under our credit agreement and other indebtedness, our ability to continue to maintain or increase sales and profits of our operations, and the sufficiency of our cash balances and cash generated from operating, investing and financing activities for our future liquidity and capital resource needs. Reference is made in particular to forward-looking statements included in this "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," and Note 1 to the consolidated condensed financial statements. Such statements may be identified by the use of forward-looking terminology such as "may", "will", "expect", "believe", "estimate", "anticipate", "intend", "continue", or similar terms, variations of such terms or the negative of such terms. The forward-looking statements included in this Report are made as of the date hereof or as of the date specified and are based on management's current expectations and beliefs. Such statements are subject to a number of assumptions, risks, uncertainties and other factors, which are set forth in "Item 1A. Risk Factors" and elsewhere in our Annual Report on Form 10-K for the year ended December 31, 2017, and subsequent reports filed with or furnished to the Securities and Exchange Commission, and which could cause actual results to differ materially from that described in the forward-looking statements. Except as required by law, we expressly disclaim any obligation or undertaking to update any forward-looking statements to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

The following discussion and analysis should be read in conjunction with, and is qualified in its entirety by, our consolidated financial statements and related notes thereto included elsewhere in this Report and in our Annual Report on Form 10-K for the year ended December 31, 2017.

Overview

Gentherm Incorporated is a global technology and industry leader in the design, development, and manufacturing of innovative thermal management technologies. Our products provide solutions for automotive passenger comfort and convenience, battery thermal management, remote power generation, patient temperature management, environmental product testing and other consumer and industrial temperature control needs. Our automotive products can be found on the vehicles of nearly all major automotive manufacturers operating in North America, Europe and Asia. We operate in locations aligned with our major customers' product strategies in order to provide locally enhanced design, integration and production capabilities and to identify future thermal technology product opportunities in both automotive and other markets. We concentrate our research on the development of new technologies and new applications from existing technologies to create product and market opportunities for a wide array of thermal management solutions.

Our automotive products are sold to automobile and light truck OEMs or their tier one suppliers. Inherent to the automotive supplier market are costs and commitments that are incurred well in advance of the receipt of orders and resulting revenues from customers. This is due in part to automotive manufacturers requiring the design, coordination and testing of proposed new components and sub-systems. Revenues from these expenditures are typically not realized for two to three years due to this development cycle.

The Company has two reportable segments for financial reporting purposes: Automotive and Industrial. See Note 5 to our consolidated condensed financial statements for a description of our reportable segments as well as their proportional contribution to the Company's reported product revenues and operating income. The financial information used by our chief operating decision maker to assess operating performance and allocate resources is based on these reportable segments.

Etratech

On November 1, 2017, we acquired substantially all of the assets and assumed substantially all of the operating liabilities of Etratech Inc. ("Etratech"), an Ontario corporation and all of the outstanding shares of Etratech Hong Kong, an entity organized under the laws of Hong Kong, in an all-cash transaction. Etratech manufactures advanced electronic controls and control systems for the automotive, RV and marine, security, medical and other industries. Etratech's world headquarters and North American manufacturing operations are located in Burlington, Canada. See Note 3 to the consolidated condensed financial statements for additional information regarding the acquisition of Etratech.

New Strategic Plan

On June 25, 2018, Gentherm announced a new strategic plan intended to improve business performance and position the company to deliver above-market growth and improved profitability to its shareholders. An important element of the strategy is the Fit-for-Growth initiative that focuses on purchasing excellence, rationalization of research and development activities and expenses, reducing selling, general and administrative expense, minimization or elimination of investments in non-core areas and developing a manufacturing footprint commensurate with the new plan. Non-core areas of investment so far identified under the Fit-for-Growth initiative are concentrated in the following areas of Gentherm's industrial segment: California Advanced Research and Development, Gentherm Global Power Technologies (GPT) and Cincinnati Sub Zero's Industrial Chamber business (CSZ-IC).

The strategy also identified several product categories the Company will exit, including furniture, aviation, battery management electronics, industrial battery packs, automotive thermoelectric generators and other non-core electronics.

See Note 1 to our consolidated condensed financial statements for information about our Fit-for-Growth initiative, related cost savings and related restructuring costs.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated condensed financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. See Note 2 to our consolidated condensed financial statements for information about critical accounting policies, accounting standard updates adopted during the six-month period ended June 30, 2018 and their impact on the Company's consolidated financial statements, and recently issued accounting policies not yet adopted.

Results of Operations Second Quarter 2018 Compared with Second Quarter 2017

Product Revenues. Product revenues for the three-month period ended June 30, 2018 ("Second Quarter 2018") were \$263.8 million compared with product revenues of \$243.4 million for the three-month period ended June 30, 2017 ("Second Quarter 2017"), an increase of \$20.4 million, or 8%. Higher product revenues in the automotive segment, which increased by \$25.0 million, or 12%, to \$240.8 million, were partially offset by lower industrial segment product revenues which decreased by \$4.6 million, or 17%, to \$23.0 million. The higher automotive segment sales included \$15.2 million related to Etratech and a favorable effect from currency translation of \$6.5 million. Etratech was acquired on November 1, 2017 and therefore no product revenue was reported for Etratech during Second Quarter 2017. On a pro-forma basis, Etratech revenue increased more than 7%.

Without the benefit of the currency translation and adjusting for the Etratech acquisition, automotive segment product revenue would have increased by 2%. This increase occurred despite lower automotive production volumes in North America, our most important geographic market. These increases were partially offset by annual price reductions totaling \$6.5 million and from a lower average selling price of climate controlled seats ("CCS") resulting from certain vehicle programs changing technologies from the higher priced active cooling application to heated and ventilated seating technology. In North America, which represented approximately 47% of our automotive revenue during Second Quarter 2018, automotive production decreased by 2.5% during Second Quarter 2018. Lower production significantly impacted two important customers in Second Quarter 2018. Automotive production at Ford, representing 11% of our product revenues, was down more than 13% in North America and production for Hyundai, representing 8% of our product revenues, was down by 5% in Korea and down 10% in North America. These lower production volumes disproportionately impacted our CCS products more than our other products. All of our other automotive products had higher revenue despite the weak production volumes. Battery Thermal Management products ("BTM"), which includes the actively cooled version launched this year, grew by \$4.6 million, or 170%, to \$7.2 million due to the launch of the second vehicle program with actively cooled BTM on the Jeep Wrangler in addition to the first ever actively cooled BTM launched on the Mercedes S-Class during the 2018 first quarter. Other programs showing significant growth included Steering Wheel Heaters which increased by \$3.0 million, or 21% to \$17.5 million, automotive cable systems which grew by \$3.7 million, or 17%, to \$25.6 million and automotive seat heaters which grew by \$6.4 million, or 9%, to \$80.2 million. On a combined basis all automotive product revenue, adjusting for currency translation and the Etratech acquisition and excluding CCS, grew by nearly 10%.

Product revenues from Gentherm Global Power Technologies ("GPT"), included in the industrial segment, totaled \$5.2 million which represented a decrease of \$2.3 million, or 31%. This decrease was mainly due to significantly lower custom project revenue. Custom projects, which typically represent more than 50% of GPT's product revenue, tend to vary significantly period-to-period due to timing of the relatively large per unit revenue. Revenue for Cincinnati Sub-Zero Products, LLC ("CSZ") during Second Quarter 2018 was \$17.8 million, representing a decrease of \$2.3 million, or 11%. This decrease was mainly due to lower product revenue on climate testing chambers offset partially by higher product revenues of medical products. The climate chamber product revenue decrease of \$2.7 million, or 20%, was primarily due to unusually high product revenues during Second Quarter 2017 which benefited

from the shipment of several large custom projects. CSZ's medical product revenues increased by \$386 thousand, or 5%, during the Second Quarter 2018.

Cost of Sales. Cost of sales increased to \$189.3 million during Second Quarter 2018 from \$165.1 million during Second Quarter 2017. This increase of \$24.2 million, or 15%, was due to the higher product revenue and a lower gross margin percentage. The gross margin percentage during Second Quarter 2018 decreased to 28.2% from 32.2% during Second Quarter 2017 primarily due to changes in product mix, timing differences between annual customer price decreases compared to supplier cost reductions, lower margin on BTM associated with the launch phase of the new actively cooled technology programs and the lower margin of Etratech, partially offset by fixed cost leverage from higher unit volume. An unfavorable shift in product mix largely was due to lower sales for higher margin products including CCS and GPT. Annual price reductions start in the first quarter and are expected to be offset by lower supplier and other costs as those programs begin to take effect throughout the year. The new actively cooled battery thermal management product being launched in our Macedonia facility is anticipated to generate annual revenue in the range of \$50 to \$60 million but is still in the early phase with only \$4.5 million in product revenues during the Second Quarter 2018. Lower gross margin on this product during this period is due to launch related expenses and higher fixed overhead costs, including depreciation expense, being incurred in anticipation for the much higher expected volumes. We expect that higher revenues of BTM units will offset these expenses in future periods.

On July 6, 2018, tariffs announced by the Office of the United States Trade Representative (USTR) under the Section 301 Action went into effect. All items identified as classified under the Harmonized Tariff Schedule of the United States (HTSUS) with a country of origin of China are subject to a 25% duty upon importation into the United States. Gentherm purchases raw material components, including products manufactured in our China facilities, that are subject to the tariff. As a result, we estimate higher raw material expenses ranging from \$3 to \$5 million during the second half of 2018. This estimate includes the 25% duty effecting identified items under HTSUS, plus an additional 10% duty on a second statement of goods that has been proposed but has not gone into effect. We are working with our suppliers and customers to mitigate the impact from these tariffs to the Company's operating results.

Net Research and Development Expenses. Net research and development expenses were \$21.0 million during Second Quarter 2018 compared to \$21.4 million in Second Quarter 2017, a decrease of \$385 thousand, or 2%. Higher research and development reimbursements totaling \$3.0 million was partially offset by higher research and development expenses. These increased expenses were primarily driven by higher costs for additional resources, including personnel, focused on application engineering for new production programs of existing products, development of new products and a program to develop the next generation of seat comfort products. The increase also included approximately \$712 thousand in foreign currency translation and the net research and development expenses of Etratech totaling \$630 thousand. New product development included automotive cooled storage devices, automotive interior thermal management devices, medical thermal management devices, battery thermal management devices, battery management systems, advanced automotive electronics solutions and other potential products. We expect that the new strategy announced on June 25, 2018 will result in a decrease in research and development expenses and a reallocation of certain resources to products that meet the requirements of the new focused growth strategy.

Research and development reimbursement totaled \$4.6 million during Second Quarter 2018 and \$1.6 million during Second Quarter 2017. This increase was mainly attributable to development expense reimbursements paid by customers for products launched during the period and the addition of Etratech.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$31.6 million during Second Quarter 2018, a decrease of \$134 thousand from \$31.8 million during Second Quarter 2017. Increases in selling, general and administrative expenses associated with the acquisition of Etratech totaling \$1.3 million, mark-to-market adjustments on cash settled stock options totaling \$889 thousand and foreign currency translation totaling \$392 thousand, were more than offset by lower expenses associated with the early cost reduction activities of the Company's new strategic initiatives.

Foreign currency gain (loss). During Second Quarter 2018 we incurred a net foreign currency gain of \$5.2 million which included a net realized gain of \$632 thousand and a net unrealized gain of \$4.5 million. The unrealized gain is primarily the result of holding significant amounts of U.S. Dollar ("USD") cash at our subsidiaries in Europe which have the European Euro ("EUR") as the functional currency and due to certain intercompany relationships between these European subsidiaries and our U.S. based companies. During Second Quarter 2018, the USD strengthened relative to the EUR. If the USD begins weakening, we will likely have unrealized currency losses whereas if the USD continues to strengthen we will likely have additional unrealized gains. Second Quarter 2017, we had a foreign currency loss of \$13.3 million. In comparison to Second Quarter 2017, the foreign currency impact in Second Quarter 2018 was lower due to a smaller change in currency exchange rates during Second Quarter 2018 as compared to Second Quarter 2017.

Income Tax Expense. We recorded an income tax expense of \$3.1 million during Second Quarter 2018 representing an effective tax rate of 16% on earnings before income tax of \$19.7 million. During Second Quarter 2017, we recorded an income tax expense of \$2.4 million on earnings before tax of \$10.9 million, or 22%. The effective tax rate for Second Quarter 2018 differed from the Federal statutory rate of 21% primarily due to the impact of discrete adjustments, including favorable excess tax benefits on stock option exercises and certain intercompany transactions which disproportionately benefited lower tax rate jurisdictions which were partially offset by the international provisions from the U.S. tax reform, such as global intangible low-tax income (“GILTI”), enacted in December 2017. The effective tax rate for Second Quarter 2017 was lower than the U.S. Federal rate of 34% primarily due to the impact of lower statutory rates for our subsidiaries operating in foreign jurisdictions.

Industrial Segment Operating Loss. The Industrial segment, which includes CSZ, GPT and our advanced research and development activities, reported an operating loss totaling \$7.9 million and \$2.7 million during Second Quarter 2018 and Second Quarter 2017, respectively. We incurred these losses for several reasons. First, the advanced research and development activities, the total cost for which were \$3.1 million and \$3.3 million, during Second Quarter 2018 and Second Quarter 2017, respectively, are focused on products and technologies that are currently not generating product revenues. Second, in conjunction with the Fit-for-Growth initiative, some of these advanced research and development activities have been curtailed or ceased and a process has been started to consolidate our advanced research facilities into few locations. These changes are expected to lead to lower spending rates in future periods. Because of this, the industrial segment operating loss included a portion of the restructuring charge totaling \$3.7 million. We expect that the remaining advanced technology projects will generate profitable revenue in future periods. Next, CSZ’s \$1.2 million of expenses associated with a new direct sales force is not yet fully offset by a corresponding increase in the amount of revenue and related operating income. We continue to believe that the direct sales force will lead to higher CSZ product revenue in future periods that will generate operating profits in excess of the costs for the direct sales team.

Results of Operations First Half 2018 Compared with First Half 2017

Product Revenues. Product revenues for the six-month period ended June 30, 2018 (“First Half 2018”) were \$525.7 million compared with product revenues of \$492.6 million for the six-month period ended June 30, 2017 (“First Half 2017”), an increase of \$33.0 million, or 7%. Higher product revenues in the automotive segment which increased by \$44.2 million, or 10%, to \$481.8 million were partially offset by lower industrial segment product revenues which decreased by \$10.2 million, or 19%, to \$44.8 million. The higher automotive segment sales included \$30.4 million related to the acquisition of Etratech and a favorable effect from currency translation of \$17.0 million. Etratech was acquired on November 1, 2017 and therefore no product revenue was reported for Etratech during First Half 2017. On a pro-forma basis, Etratech revenue increased by 13%.

Without the benefit of the currency translation and adjusting for the Etratech acquisition, automotive segment product revenue would have been unchanged during First Half 2018 as compared to First Half 2017. Growth measured on this basis during Second Quarter 2018 was fully offset by decreased revenue in the 2018 first quarter.

Product revenues from GPT, included in the industrial segment, totaled \$9.73 million which represented a decrease of \$5.2 million, or 35%. This decrease was mainly due to significantly lower custom project revenue. Custom projects, which typically represent more than 50% of GPT’s product revenue, tend to vary significantly period-to-period due to timing of the relatively large per unit revenue. Revenue for CSZ during First Half 2018 was \$35.1 million, representing a decrease of \$5.0 million, or 12.5%. This decrease was mainly due to lower climate chamber product revenue which decreased by \$2.7 million, or 12%, to \$20.5 million as a result of unusually high product revenues during First Half 2017 which benefited from the shipment of several large customer projects. CSZ’s medical sales also declined by \$2.3 million, or 13%, to \$14.6 million mainly due to a \$2.6 million decline in sales of the blood heater-cooler product that was higher during First Half 2017 due to the regulatory disruptions impacting a competitive product.

Cost of Sales. Cost of sales increased to \$372.7 million during First Half 2018 from \$329.2 million during First Half 2017. This increase of \$43.5 million, or 13%, was due to the higher product revenue and a lower gross margin percentage. The gross margin percentage during First Half 2018 decreased to 29.1% from 33.2% during First Half 2017 mainly as a result of timing differences between annual customer price decreases compared to supplier cost reductions, increased manufacturing expenses, changes in product mix favoring lower margin products and lower margin on BTM associated with the launch phase of the new actively cooled technology programs and the lower margin of Etratech, partially offset by fixed cost leverage from higher unit volume. Annual price reductions start in the first quarter and are expected to be offset by lower supplier and other costs as those programs begin to take effect throughout the year. Increased expenses included labor expense inflation at our Ukraine factory, and factory launch expenses for the new advanced battery thermal management product in our Macedonia facility. An unfavorable shift in product mix largely was due to lower sales for higher margin products including CCS, GPT and the medical products of CSZ.

Net Research and Development Expenses. Net research and development expenses were \$44.3 million during First Half 2018 compared to \$40.9 million in First Half 2017, an increase of \$3.4 million, or 8%. This increase was primarily driven by higher costs for additional resources, including personnel, focused on application engineering for new production programs of existing products, development of new products and a program to develop the next generation of seat comfort products. The increase also included approximately \$1.5 million in foreign currency translation and the net research and development expenses of Etratech totaling \$1.3 million. These amounts were partially offset by \$3.1 million in higher research and development reimbursements.

Research and development reimbursement totaled \$7.0 million during First Half 2018 and \$3.8 million during First Half 2017. This increase was mainly attributable to development expense reimbursements paid by customers for products launched during the period and the addition of Etratech.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased to \$65.4 million during First Half 2018, an increase of \$2.8 million, or 4%, from \$62.6 million during First Half 2017. This increase includes approximately \$1.4 million in higher expenses related to currency translation and \$3.2 million in selling, general and administrative expenses of Etratech. These increases were partially offset by lower mark-to-market adjustments on cash settled stock options totaling \$706 thousand and by lower expenses associated with the early cost reduction activities of the Company's new strategic initiatives.

Foreign currency gain (loss). During First Half 2018, we incurred a net foreign currency gain of \$600 thousand which included a net realized loss of \$294 thousand and a net unrealized gain of \$890 thousand. The unrealized gain is primarily the result of holding significant amounts of USD cash at our subsidiaries in Europe which have EUR as the functional currency and due to certain intercompany relationships between these European subsidiaries and our U.S. based companies. During First Half 2018, the USD strengthened relative to the EUR. If the USD begins to weaken we will likely have unrealized currency losses whereas if the USD continues to strengthen we will likely have additional unrealized gains. In First Half 2017, we had a net foreign currency loss of \$14.6 million. In comparison to First Half 2017, the foreign currency impact in First Half 2018 was lower due to a smaller change in currency exchange rates during First Half 2018 as compared to First Half 2017.

Income Tax Expense. We recorded an income tax expense of \$6.1 million during First Half 2018 representing an effective tax rate of 17% on earnings before income tax of \$35.7 million. During First Half 2017, we recorded an income tax expense of \$9.6 million on earnings before tax of \$43.5 million, or 22%. The effective tax rate for First Half 2018 differed from the Federal statutory rate of 21% primarily due to the impact of discrete adjustments, including a favorable excess tax benefit on stock option exercises, certain intercompany transactions which disproportionately benefited lower tax rate jurisdictions and the impact of lower statutory rates for our subsidiaries operating in foreign jurisdictions offset by the international provisions from the U.S. tax reform, such as GILTI, enacted in December 2017. The effective tax rate for First Half 2017 was lower than the U.S. Federal rate of 34% primarily due to the impact of lower statutory rates for our subsidiaries operating in foreign jurisdictions.

Industrial Segment Operating Loss. The Industrial segment, which includes CSZ, GPT and our advanced research and development activities, reported an operating loss totaling \$14.6 million and \$5.1 million during First Half 2018 and First Half 2017, respectively. We incurred these losses for several reasons. First, the advanced research and development activities, the total cost for which were \$6.9 million and \$7.3 million, during First Half 2018 and First Half 2017, respectively, are focused on products and technologies that are currently not generating product revenues. Second, in conjunction with the Fit-for-Growth initiative, some of these activities have been curtailed or ceased and a process has been started to consolidate our advanced research facilities into few locations. These changes are expected to lead to lower spending rates in future periods. Because of this, the industrial segment operating loss included a portion of the restructuring charge totaling \$3.8 million. We expect that the remaining advanced technology projects will generate profitable revenue in future periods. Next, CSZ's \$2.4 million of expenses associated with a new direct sales force is not yet fully offset by a corresponding increase in the amount of revenue and related operating income. We continue to believe that the direct sales force will lead to higher CSZ product revenue in future periods that will generate operating profits in excess of the costs for the direct sales team.

Liquidity and Capital Resources

Cash and Cash Flows

The Company has funded its financial needs primarily through cash flows from operating activities and equity and debt financings. Our new strategic plan sets forth a capital allocation strategy that includes a targeted debt to earnings leverage ratio and allows for some of our cash flow to be paid back to investors through common stock buybacks. On June 25, 2018 our board increased the Company's stock buyback authorization to \$300 million under which we had \$274 remaining as of June 30, 2018. This authorization expires on December 31, 2020. Based on its current operating plan, management believes cash and cash equivalents at June 30, 2018, together with cash flows from operating activities, and borrowing available under our credit agreement, are sufficient to meet operating and capital expenditure needs, and to service debt, for at least the next 12 months. However, if cash flows from

operations decline, we may need to obtain alternative sources of capital and reduce or delay capital expenditures, acquisitions and investments, all of which could impede the implementation of our business strategy and adversely affect our results of operations and financial condition. In addition, it is likely that we will need to complete one or more equity or debt financings if we consummate any significant acquisition or a number of smaller acquisitions. There can be no assurance that such capital will be available at all or on reasonable terms, which could adversely affect our future operations and business strategy.

The following table represents our cash and cash equivalents and short-term investments:

	Six Months Ended June 30, 2018	Year Ended December 31, 2017
	(In thousands)	
Cash and cash equivalents at beginning of period	\$ 103,172	\$ 177,187
Cash from operating activities	32,543	49,880
Cash used in investing activities	(21,455)	(117,688)
Cash used in financing activities	(47,899)	(31,564)
Foreign currency effect on cash and cash equivalents	(1,004)	25,357
Cash and cash equivalents at end of period	<u>\$ 65,357</u>	<u>\$ 103,172</u>

Cash Flows From Operating Activities

We manage our cash, cash equivalents and short-term investments in order to fund operating requirements and preserve liquidity to take advantage of future business opportunities. The following table compares the cash flows from operating activities during First Half 2018 and First Half 2017:

	Six Months Ended June 30,		
	2018	2017	Change
Operating Activities:	(In thousands)		
Net income	\$ 29,625	\$ 33,915	\$ (4,290)
Non-cash adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	25,823	21,191	4,632
Deferred income taxes	(1,799)	(2,278)	479
Stock compensation	4,063	4,761	(698)
Defined benefit plan expense	(103)	94	(197)
Provision for doubtful accounts	204	6	198
Loss on sale of property and equipment	2,156	249	1,907
Net income before changes in operating assets and liabilities	59,969	57,938	2,031
Changes in operating assets and liabilities:			
Accounts receivable	(17,469)	(6,949)	(10,520)
Inventory	1,631	1,149	482
Prepaid expenses and other assets	(12,094)	(5,147)	(6,947)
Accounts payable	10,540	(2,932)	13,472
Accrued liabilities	(10,034)	(37,944)	27,910
Net cash provided by operating activities	<u>32,543</u>	<u>6,115</u>	<u>26,428</u>

Cash provided by operating activities during First Half 2018 was \$32.5 million, representing an increase of \$26.4 million from cash provided in operating activities during First Half 2017, which was \$6.1 million. The following table highlights significant differences between the operating cash flows for the periods ending June 30, 2018 and 2017, respectively:

	(In thousands)
Net cash provided by operating activities during First Half 2017	\$ 6,115
Increase from higher net income before changes in operating assets and liabilities	2,031
Taxes paid related to the Reorganization (as defined below)	35,100
Other changes in working capital, net.	(10,703)
Net cash provided by operating activities during First Half 2018	<u>\$ 32,543</u>

Net cash provided by operating activities before changes in operating assets and liabilities increased during First Half 2018 due to higher revenue offset partially by higher expenses.

In addition, operating cash flows were lower due to income tax payments related to reorganization transactions of our North American business operations (the "Reorganization"). As part of our original integration plan to eliminate redundancies associated with the 2011 acquisition of Gentherm GmbH (formerly named W.E.T. Automotive Systems AG), the Windsor Operations were consolidated into our existing European and North American facilities.

Related to these reorganization transactions, the Company declared intercompany dividends, incurred and paid withholding taxes to the Canadian Revenue Agency of \$7.6 million during 2016. Additionally, the Company incurred income tax expense of \$2.5 million related to the intercompany dividends. These amounts incurred are expected to cover all future intercompany dividends needed to distribute the remaining earnings of the subsidiary to its parent in conjunction with the potential future liquidation of the subsidiary.

In addition to the \$7.6 million of withholding tax and \$2.5 million of income taxes, the Company was required to make a one-time income tax payment of approximately \$32.6 million. The one-time income tax payment was accrued during the first quarter of 2016; however, the Company also recorded an offsetting deferred charge for approximately the same amount because the one-time income tax payment will result in tax deductions against income taxes in future periods. Therefore, the income tax payment did not have a material impact on the Company's earnings during the first quarter of 2016 nor any subsequent quarter. The withholding tax payment was paid entirely in 2016. The income tax payments of \$2.5 million and \$32.6 million were paid during the first quarter of 2017.

Other changes in working capital, net primarily consist of favorable cash flows related to accounts receivable, prepaid expenses and other assets and unfavorable amounts related to inventory and accounts payable.

Working Capital

The following table illustrates changes in working capital during First Half 2018:

	(In thousands)
Working capital at December 31, 2017	\$ 289,754
Loan repayments	(46,742)
U.S. Revolving Note borrowings	15,000
Stock buyback	(20,241)
Foreign currency effect on working capital	(4,449)
Increase in accounts receivable	17,469
Increase in tax receivables	10,240
Increase in accounts payable	(10,540)
Adoption of ASU 2016-16	22,585
Adoption of ASU 2014-09	(4,105)
Other Items	5,911
Working capital at June 30, 2018	<u>\$ 274,882</u>

Our working capital decreased due to a net repayment of a portion of the Company's outstanding debt balance, cash paid to the buy back Common Stock and a decrease in accounts payable, partially offset by three significant increases, including currency translation, an increase in accounts receivable and tax receivable, and non-cash adjustments from the adoption of new accounting standard updates. During First Half 2018, management repaid \$45.0 million of the outstanding U.S. Revolving Note balance, \$1.2 million of the outstanding DEG Vietnam Loan and \$0.5 million of the outstanding DEG China Loan from cash from operations and cash repatriated from foreign subsidiaries. The currency impact of \$2.8 million on working capital is mainly the result of the currency translation of working capital at our European subsidiaries. At June 30, 2018, the U.S. Dollar/European Euro exchange rate was \$1.17 as compared with an exchange rate of \$1.23 at December 31, 2017. Approximately 20% of our product revenues are generated in Europe. Working capital was also impacted by an increase in account receivable, which was driven by higher sales in June 2018 as compared to December 2017. Our sales are typically lower in December each year due to temporary factory holiday shut-downs at our automotive customers. During First Half 2018, Gentherm recognized an increase to current tax receivables related to timing of required payments to tax authorities. Lastly, working capital was impacted by the adoption of Accounting Standard Update 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory" and Accounting Standard Update 2014-09, "Revenue from Contracts with Customers (Topic 606)." See Note 2 to our consolidated condensed financial statements for information about these accounting standard updates and their impact on the Company's consolidated condensed financial statements.

Cash Flows From Investing Activities

Cash used in investing activities was \$21.5 million during First Half 2018, reflecting purchases of property and equipment related to the expansion of production capacity, including at our newest facilities in Mexico, Vietnam, Macedonia and our Etratech facility in Canada.

Cash Flows From Financing Activities

Cash used in financing activities was \$47.9 million during First Half 2018, reflecting payments of principal on the U.S. Revolving Note, the DEG China Loan and the DEG Vietnam Loan totaling \$46.7 million in aggregate. As of June 30, 2018, the total availability under the U.S. Revolving Note was \$250.9 million. Cash was also paid for cancellations of restricted stock awards totaling \$882 thousand, and for the repurchase of Common Stock totaling \$20.2 million.

Off-Balance Sheet Arrangements

We use letters of credit to guarantee our performance under specific construction contracts executed by our subsidiaries, GPT and CSZ. The expiration dates of the letter of credit contracts coincide with the expected completion date of the contract. Extensions are normally made if performance obligations continue beyond the expected completion date. At June 30, 2018, we had outstanding letters of credit of \$66 thousand, a decrease from \$141 thousand at December 31, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk for changes in interest rates relates primarily to our debt obligations and foreign currency contracts. We have in the past, and may in the future, place our investments in bank certificates of deposits, debt instruments of the U.S. government, and in high-quality corporate issuers.

We are exposed to market risk from changes in foreign currency exchange rates, short-term interest rates and price fluctuations of certain material commodities such as copper. Market risks for changes in interest rates relate primarily to our debt obligations under our Credit Agreement. Foreign currency exchange risks are attributable to sales to foreign customers and purchases from foreign suppliers not denominated in a location's functional currency, foreign plant operations, intercompany indebtedness, intercompany investments and include exposures to the European Euro, Mexican Peso, Canadian Dollar, Hungarian Forint, Macedonian Denar, Ukrainian Hryvnia, Japanese Yen, Chinese Renminbi, Korean Won and Vietnamese Dong.

The Company regularly enters into derivative contracts with the objective of managing its financial and operational exposure arising from these risks by offsetting gains and losses on the underlying exposures with gains and losses on the financial instruments used to hedge them. The maximum length of time over which we hedge our exposure to foreign currency exchange risks is one year. We had foreign currency derivative contracts with a notional value of \$22.4 million and \$29.3 million outstanding at June 30, 2018 and December 31, 2017, respectively.

The maximum length of time over which we hedge our exposure to price fluctuations in material commodities is two years. We had copper commodity swap contracts with a notional value of \$0 and \$404 thousand outstanding at June 30, 2018 and December 31, 2017, respectively.

We do not enter into derivative financial instruments for speculative or trading purposes. Our hedging relationships are formally documented at the inception of the hedge, and hedges must be highly effective in offsetting changes to future cash flows on hedged transactions both at the inception of a hedge and on an ongoing basis to be designated for hedge accounting treatment. For derivative contracts which can be classified as a cash flow hedge, the effective portion of the change in the fair value of the derivative is recorded to accumulated other comprehensive income (loss) in the consolidated condensed balance sheet. When the underlying hedge transaction is realized, the gain or loss included in accumulated other comprehensive income (loss) is recorded in earnings in the consolidated condensed statements of income on the same line as the gain or loss on the hedged item attributable to the hedged risk. We record the ineffective portion of foreign currency hedging instruments, if any, to foreign currency gain (loss) in the consolidated condensed statements of income. Though we continuously monitor the hedging program, derivative positions and hedging strategies, foreign currency forward exchange agreements have not always been designated as hedging instruments for accounting purposes.

The Company uses an income approach to value derivative instruments, analyzing quoted market prices to calculate the forward values and then discounts such forward values to the present value using benchmark rates at commonly quoted intervals for the instrument's full term. Information related to the fair values of all derivative instruments in our consolidated condensed balance sheet as of June 30, 2018 is set forth in Note 7 to the consolidated condensed financial statements included herein.

Interest Rate Sensitivity

The table presents principal cash flows and related weighted average interest rates by expected maturity dates for each of the Company's debt obligations. The information is presented in U.S. dollar equivalents, which is the Company's reporting currency. The instruments actual cash flows are denominated in US dollars (\$USD) or European Euros (€EUR), as indicated in parentheses.

June 30, 2018

	Expected Maturity Date						Total	Fair Value
	2018	2019	2020	2021	2022	Thereafter		
	(In thousands except rate information)							
Liabilities								
Long Term Debt:								
Fixed Rate (€EUR)	\$ 467	\$ 933	—	—	—	—	\$ 1,400	\$ 1,400
Fixed Interest Rate	4.25%	4.25%					4.25%	
Variable Rate (\$USD)	—	—	—	—	\$ 99,000	—	\$ 99,000	\$ 99,000
Average Interest Rate					3.59%		3.59%	
Fixed Rate (\$USD)	\$ 1,250	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 1,250	\$ 12,500	\$ 12,200
Fixed Interest Rate	5.21%	5.21%	5.21%	5.21%	5.21%	5.21%	5.21%	

Exchange Rate Sensitivity

The table below provides information about the Company's foreign currency forward exchange rate agreements that are sensitive to changes in foreign currency exchange rates. The table presents the notional amounts and weighted average exchange rates by expected (contractual) maturity dates for each type of foreign currency forward exchange agreement. These notional amounts generally are used to calculate the contractual payments to be exchanged under the contract.

June 30, 2018

Anticipated Transactions And Related Derivatives	Expected Maturity or Transaction Date						Total	Fair Value
	2018	2019	2020	2021	2022	Thereafter		
(In thousands except rate information)								
\$US functional currency								
Forward Exchange Agreements:								
(Receive MXN/Pay USD\$)								
Total Contract Amount	\$ 18,322	\$ 4,075	—	—	—	—	\$ 22,397	\$ (454)
Average Contract Rate	19.65	19.63					19.65	

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2018, our disclosure controls and procedures were effective to ensure the information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods prescribed by the Securities and Exchange Commission, and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to litigation from time to time in the ordinary course of business, however there is no current material pending litigation to which we are a party and no material legal proceeding was terminated, settled or otherwise resolved during the three or six months ended June 30, 2018.

ITEM 1A. RISK FACTORS

Rising threats of international tariffs, including tariffs applied to goods traded between the United States and China, could materially and adversely affect our business and results of operations.

Since the beginning of 2018, there has been increasing rhetoric, in some cases coupled with legislative or executive action, from several U.S. and foreign leaders regarding the possibility of instituting additional tariffs against foreign imports of certain materials and products. In March and April of 2018, the U.S. and China have applied tariffs to certain of each other’s exports. The institution of trade tariffs both globally and between the U.S. and China specifically carries the risk of negatively impacting overall economic conditions, which could have negative repercussions on the Company. Furthermore, imposition of tariffs has caused and could cause further increases in the costs of our raw materials, which we may not be able to pass on to our customers, which would directly and negatively impact our business.

There were no other material changes in our risk factors previously disclosed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017. You should carefully consider the risks and uncertainties described therein.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities During Second Quarter 2018

<u>Period</u>	<u>(a) Total Number of Shares Purchased (1)</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Repurchased as Part of Publicly Announced Plans or Programs</u>	<u>(d) Approximate Dollar Value of Shares That May Yet to Be Purchased Under the Plans or Programs (2)</u>
April 1, 2018 to April 30, 2018	—	\$ —	—	94,674,079
May 1, 2018 to May 31, 2018	210,554	\$ 34.84	210,554	87,338,628
June 1, 2018 to June 30, 2018	335,912	\$ 38.42	335,912	274,433,389

- (1) All shares were purchased on the open-market in accordance with Gentherm’s Stock Repurchase Program.
- (2) The Stock Repurchase Program, authorized and announced on December 16, 2016, and amended June 25, 2018, allows Gentherm to repurchase shares up to \$300 million. The Stock Repurchase Program expires on December 16, 2020. The authorization of this Stock Repurchase Program does not require that the Company repurchase any specific dollar value or number of share and may be modified, extended or terminated by the Company’s Board of Directors at any time.

ITEM 6. EXHIBITS

Exhibits to this Report are as follows:

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit / Appendix Number	Filing Date
10.1	Amended and Restated Gentherm Incorporated 2013 Equity Incentive Plan	X				
10.2.1*	Form of Restricted Stock Unit Agreement under the 2013 Equity Incentive Plan (Performance-Based Grant)		8-K		10.1	6/13/18
10.2.2*	Form of Restricted Stock Unit Agreement under the 2013 Equity Incentive Plan (Time-Based Grant)		8-K		10.2	6/13/18
10.2.3*	Separation of Employment Agreement between Gentherm Incorporated and Darren Schumacher, dated as of May 24, 2018		8-K		10.3	6/13/18
10.3	Fourth Amendment to Credit Agreement, dated April 24, 2016, by and among Gentherm Incorporated, certain of its direct and indirect subsidiaries, the lenders party thereto, and Bank of America, N.A., as administrative agent.		8-K		10.1	4/24/18
31.1	Section 302 Certification – CEO	X				
31.2	Section 302 Certification – CFO	X				
32.1**	Section 906 Certification – CEO	X				
32.2**	Section 906 Certification – CFO	X				
101.INS	XBRL Instance Document.	X				
101.SCH	XBRL Taxonomy Extension Schema Document.	X				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.	X				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.	X				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.	X				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.	X				

* Indicates management contract or compensatory plan or arrangement

** Documents are furnished not filed

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Gentherm Incorporated

/s/ PHILLIP EYLER

Phillip Eyler
Chief Executive Officer
(Duly Authorized Officer)

Date: July 31, 2018

/s/ BARRY G. STEELE

Barry G. Steele
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

Date: July 31, 2018

AMENDED AND RESTATED GENTHERM INCORPORATED
2013 Equity Incentive Plan
[As amended and restated May 2018]

1. Definitions. As used herein, the following definitions shall apply:

- (a) “Award” means any stock option, stock appreciation right, restricted stock, restricted stock unit, performance share award or other stock-based award granted under the Plan.
- (b) “Board” means the Gentherm Incorporated Board of Directors.
- (c) “Committee” means a committee consisting of two or more members of the Board, each of whom may be a “non-employee director” as defined under Rule 16b-3 of the Rules and Regulations under the Securities Exchange Act of 1934, as amended, or any similar or successor provision, as appointed by the Board to administer the Plan. In the absence of any action of the Board to the contrary, the Compensation Committee of the Board shall comprise the Committee.
- (d) “Corporation” means Gentherm Incorporated, a Michigan corporation, or any successor thereof.
- (e) “Discretion” means in the sole discretion of the Committee, with no requirement whatsoever that the Committee follow past practices, act in a manner consistent with past practices, or treat a Participant (as hereinafter defined) in a manner consistent with the treatment afforded other Participants with respect to the Plan, which may be set forth in a written grant agreement or otherwise.
- (f) “409A Award” means any Award that is treated as a deferral of compensation subject to the requirements of Section 409A of the Code.
- (g) “Incentive Option” means an option to purchase Common Stock of the Corporation which meets the requirements set forth in the Plan and also meets the definition of an incentive stock option set forth in Section 422 of the Code.
- (h) “Nonqualified Option” means an option to purchase Common Stock of the Corporation which meets the requirements set forth in the Plan but does not meet the definition of an incentive stock option set forth in Section 422 of the Code.
- (i) “Other stock-based award” means any right granted under Paragraph 20 of the Plan.
- (j) “Participant” means any individual or class of individual designated by the Committee under Paragraph 6 for participation in the Plan who is or becomes (i) a key employee (including an officer or director who is also a key employee) of the Corporation or any Subsidiary, (ii) a director of the Corporation who is not also an employee of the Corporation or any Subsidiary (hereinafter sometimes referred to as an “outside director”), and (iii) a consultant or advisor of the Corporation or any Subsidiary.
- (k) “Performance share” means a grant of Common Stock of the Corporation upon the attainment of one or more performance goals during a performance period established by the Committee, as provided in Paragraph 19.
- (l) “Plan” means this Gentherm Incorporated 2013 Equity Incentive Plan, as amended and restated.
- (m) “Restricted stock” means a grant of Common Stock of the Corporation which is subject to restrictions against transfer, forfeiture and such other terms and conditions determined by the Committee, as provided in Paragraph 18.
- (n) “Restricted stock unit” means a grant of a right to earn the value of a share of Common Stock of the Corporation which is subject to restrictions against transfer, forfeiture and such other terms and conditions determined by the Committee, as provided in Paragraph 18.
- (o) “Stock appreciation right” means a right to receive the appreciation in value, or a portion of the appreciation in value, of a specified number of shares of the Common Stock of the Corporation, as provided in Paragraph 12.
-

(p) “**Subsidiary**” means any corporation, limited liability company, partnership or any other entity in which the Corporation owns, directly or indirectly, stock or other ownership interest therein, possessing more than fifty percent (50%) of the combined voting power of all classes of stock or other ownership interest.

2. Purpose of Plan. The purpose of the Plan is to provide key employees (including officers and directors who are also key employees), outside directors, consultants and advisors of the Corporation and its Subsidiaries with incentives to make significant and extraordinary contributions to the long-term performance and growth of the Corporation and its Subsidiaries, to join the interests of key employees, outside directors, consultants and advisors with the interests of the shareholders of the Corporation, and to facilitate attracting and retaining key employees, outside directors, consultants and advisors with exceptional abilities.

3. Administration. The Plan shall be administered by the Committee provided that the Board may exercise all of the Committee’s powers, authority and obligations under this Plan (and any grant agreement) at any time, in whole or in part, in the Board’s discretion. Subject to the provisions of the Plan, the Committee shall determine, from those who are or become eligible to be Participants under the Plan, the persons or class of persons to be granted Awards, the type of Awards and the amount or maximum amount of stock or rights covered by Awards to be granted to each such person or class of person, and the terms and conditions of any Awards. Subject to the provisions of the Plan, the Committee is authorized to: grant awards; determine the rights of Participants with respect to an Award upon any termination of service; determine whether, and to what extent, and under what circumstances an Award may be settled, cancelled, forfeited, exchanged or surrendered; accelerate the vesting of any Award; interpret the Plan; promulgate, amend and rescind rules and regulations relating to the Plan; and make all other determinations necessary or advisable for its administration. Interpretation and construction of any provision of the Plan by the Committee (or the Board) shall be final and conclusive. A majority of the Committee shall constitute a quorum, and the acts approved by a majority of the members present at any meeting at which a quorum is present, or acts approved in writing by a majority of the Committee, shall be the acts of the Committee.

4. Indemnification of Committee Members. In addition to such other rights of indemnification as they may have, the members of the Committee shall be indemnified by the Corporation against the reasonable expenses, including attorneys’ fees, actually and necessarily incurred in connection with the defense of any action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any action taken or failure to act under or in connection with the Plan or any Award granted hereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by the Board or paid by them in satisfaction of a judgment in any such action, suit or proceeding, except in relation to matters as to which it shall be determined in such action, suit or proceeding that such Committee member has acted in bad faith); provided, however, that within sixty (60) days after receipt of notice of institution of any such action, suit or proceeding, a Committee member shall offer the Corporation in writing the opportunity, at its own cost, to handle and defend the same.

5. Maximum Number of Shares Subject to Plan; Share Usage.

(a) The maximum number of shares of stock which may be issued pursuant to Awards granted under the Plan or with respect to which Awards may be granted under the Plan shall not exceed in the aggregate the sum of (i) 6,500,000 shares of Common Stock of the Corporation, plus (ii) the number of shares of Common Stock of the Corporation that, as of the effective date of the Plan are subject to awards granted under the Gentherm Incorporated 2006 Equity Incentive Plan or the 2011 Equity Incentive Plan and that, on or after the effective date of the Plan, expire or are terminated, surrendered or canceled without the delivery of any shares of Stock in the case of options, or are forfeited or reacquired by the Corporation, in accordance with the terms of the relevant plan, in the case of unvested restricted stock awards (in each case, subject to adjustments as provided in this Paragraph 5) (the “Share Limit”). Such Share Limit shall also be the maximum aggregate number of shares of Common Stock of the Corporation in respect of which Incentive Options may be granted under the Plan.

(b) Awards of restricted stock, restricted stock units, unrestricted stock, and dividend equivalents (including performance shares and performance units) payable in shares of Common Stock shall count against the Share Limit as 1.85 shares of Common Stock for each share of Common Stock covered by such Awards. Awards of Incentive Options, Nonqualified Options, and stock appreciation rights shall count against the Share Limit as 1.00 share of Common Stock for each share of Common Stock covered by such Awards. The full number of shares of Common Stock subject to an option or stock appreciation right shall count against the Share Limit, even if the exercise price of the such option or stock appreciation right is satisfied in whole or in part through net-settlement or by delivering

shares of Common Stock to the Corporation (by either actual delivery or attestation). Shares of Common Stock issued or to be issued under the Plan shall be authorized but unissued Common Stock or issued Common Stock that has been reacquired by the Corporation or a Subsidiary or affiliate of the Corporation. If any Common Stock covered by an Award is not purchased or is forfeited, or if an Award otherwise terminates without delivery of Common Stock subject thereto, then the number of shares of Common Stock related to such Award and subject to such forfeiture or termination shall not be counted against the limit set forth above (or included for purposes of the calculation in the proviso, above), but shall again be available for making Awards under the Plan. Notwithstanding the foregoing, there shall not be added back to the Share Limit: (x) shares of Common Stock that are subject to an option or a share-settled stock appreciation right (including those stock appreciation rights that may be settled in either shares or cash) and are not issued upon the net settlement or net exercise of option or stock appreciation right; (y) shares of Common Stock delivered to or withheld by the Corporation or a subsidiary or affiliate of the Corporation to pay the exercise price or the withholding taxes under options or stock appreciation rights; or (z) shares of Stock repurchased on the open market with the proceeds of an Option exercise.

(c) Any shares that are delivered by the Corporation, and any awards or grants that are made by, or become obligations of, the Corporation through the assumption by the Corporation or a Subsidiary of, or in substitution for, outstanding awards or grants previously made by an acquired company, shall not be counted against the number of shares available under the Plan. Consistent with the purpose of the Plan and with a view to avoiding over or under counting, the Committee shall, in its Discretion, determine the number of shares to charge against the shares remaining available under the Plan as a result of the grant or settlement of Awards made under the Plan.

(d) The number of shares with respect to each outstanding Award, the option price with respect to outstanding stock options, the grant value with respect to outstanding stock appreciation rights, and the aggregate number of shares available at any time under the Plan shall be subject to such adjustment as the Committee, in its Discretion, deems appropriate to reflect such events as stock dividends, stock splits, recapitalizations, mergers, consolidations or reorganizations of or by the Corporation; provided, however, that no fractional shares shall be issued pursuant to the Plan, no Awards may be granted under the Plan with respect to fractional shares, and any fractional shares resulting from such adjustments shall be eliminated from any outstanding Award.

6. Participants. The Committee shall determine and designate from time to time, in its Discretion, those individuals who are or who become key employees (including officers and directors who are also key employees), outside directors, consultants or advisors of the Corporation or any Subsidiary to receive Awards who, in the judgment of the Committee, are or will become responsible for the direction and financial success of the Corporation or any Subsidiary. Subject to the provisions of the Plan, the Committee may authorize in advance the grant of Awards to individuals or classes of individuals who are not at the time of Committee authorization, but who subsequently become, key employees, outside directors, consultants or advisors of the Corporation or any Subsidiary; provided, however, that (i) for all purposes of the Plan, the date of grant of any Award made to an individual pursuant to such authorization shall be no earlier than the date on which such individual becomes an employee, outside director, consultant or advisor of the Corporation or any Subsidiary, and (ii) such authorization shall prescribe the principal terms or range of terms of the Awards that may be made to such individuals or classes of individuals including, without limitation, the type or types of Awards and the number or maximum number of shares to be covered by such Awards.

7. Written Agreement. Each Award granted under the Plan shall be evidenced by a written grant agreement between the Corporation and the Participant which shall contain such provisions as may be approved by the Committee. The written grant agreement may be in an electronic medium, may be limited to a notation on the Company's books and records and, if approved by the Committee, need not be signed by a representative of the Company or a Participant. Such agreements shall constitute binding contracts between the Corporation and the Participant, and every Participant, upon acceptance of such agreement, shall be bound by the terms and restrictions of the Plan and of such agreement. The terms of each such agreement shall be in accordance with the Plan, but the agreements may include such additional provisions and restrictions determined by the Committee, provided that such additional provisions and restrictions do not violate the terms of the Plan.

8. Allotment of Shares. Subject to the terms of the Plan, the Committee shall determine and fix, in its Discretion, the number or maximum number of shares with respect to which each Participant may be granted Awards and such determination shall be set forth in the grant agreement; provided, however, that no Incentive Option may be granted under the Plan to any one Participant which would result in the aggregate fair market value, determined as of the

date the option is granted, of underlying stock with respect to which Incentive Options are exercisable for the first time by such Participant during any calendar year under any plan maintained by the Corporation (or any parent or Subsidiary of the Corporation) exceeding \$100,000.

9. Stock Options. Subject to the terms of the Plan, the Committee, in its Discretion, may grant to Participants either Incentive Options, Nonqualified Options or any combination thereof; provided, however, that an Incentive Option may only be granted to an employee of the Corporation or a Subsidiary, and in the case of a Subsidiary only if (i) the Subsidiary is treated as a disregarded entity owned by the Corporation, or (ii) the Subsidiary is a corporation (or is treated as a disregarded entity owned by a corporation) fifty percent or more of the combined voting power of all classes of stock of which is owned, directly or indirectly, by the Corporation. Each option granted under the Plan shall designate whether such option is intended to be an Incentive Option or Nonqualified Option, the number of shares covered thereby, the price per share for which the shares covered by such option may be purchased, the date on which such option was granted, the expiration date of such option, and such other terms as determined by the Committee in its Discretion.

10. Stock Option Price. The Committee, in its Discretion, shall establish the price per share for which the shares covered by the option may be purchased, which price shall be set forth in the grant agreement. With respect to an Incentive Option, such option price shall not be less than 100% of the fair market value of the stock on the date on which such option is granted; provided, however, that with respect to an Incentive Option granted to a Participant who at the time of the grant owns (after applying the attribution rules of Section 424(d) of the Code) more than 10% of the total combined voting stock of the Corporation or of any parent or Subsidiary, the option price shall not be less than 110% of the fair market value of the stock on the date such option is granted. With respect to a Nonqualified Option, the option price shall not be less than 100% of the fair market value of the stock on the date such option is granted. Fair market value of a share shall be determined by the Committee as permitted in Treas. Reg. §1.409A-1(b)(5)(iv), and may be determined by taking the mean between the highest and lowest quoted selling prices of the Corporation's stock on any exchange or other market on which the shares of Common Stock of the Corporation shall be traded on such date or, if there are no sales on such date, on the next preceding or following day on which there are sales. The option price shall be subject to adjustment in accordance with the provisions of Paragraph 5 of the Plan.

11. Payment of Stock Option Price. At the time of the exercise in whole or in part of any stock option granted hereunder, payment of the option price in full in cash or, with the consent of the Committee, in Common Stock of the Corporation, shall be made by the Participant for all shares so purchased. In the Discretion of, and subject to such conditions as may be established by, the Committee, payment of the option price may also be made by the Corporation retaining from the shares to be delivered upon exercise of the stock option that number of shares having a fair market value on the date of exercise equal to the option price of the number of shares with respect to which the Participant exercises the option. In the Discretion of the Committee, a Participant may exercise an option, if then exercisable, in whole or in part, by delivery to the Corporation of written notice of the exercise in such form as the Committee may prescribe, accompanied by irrevocable instructions to a stock broker to promptly deliver to the Corporation full payment for the shares with respect to which the option is exercised from the proceeds of the stock broker's sale of or loan against some or all of the shares (a "Regulation T Stock Option Exercise"). Such payment may also be made in such other manner as the Committee determines is appropriate, in its Discretion. No Participant shall have any of the rights of a shareholder of the Corporation under any stock option until the actual issuance of shares to said Participant, and prior to such issuance no adjustment shall be made for dividends, distributions or other rights in respect of such shares, except as provided in Paragraph 5.

12. Stock Appreciation Rights. Subject to the terms of the Plan, the Committee may grant stock appreciation rights to Participants either in conjunction with, or independently of, any stock options granted under the Plan. A stock appreciation right granted in conjunction with a stock option may be an alternative right wherein the exercise of the stock option terminates the stock appreciation right to the extent of the number of shares purchased upon exercise of the stock option and, correspondingly, the exercise of the stock appreciation right terminates the stock option to the extent of the number of shares with respect to which the stock appreciation right is exercised. Alternatively, a stock appreciation right granted in conjunction with a stock option may be an additional right wherein both the stock appreciation right and the stock option may be exercised. A stock appreciation right may not be granted in conjunction with an Incentive Option under circumstances in which the exercise of the stock appreciation right affects the right to exercise the Incentive Option or vice versa, unless the stock appreciation right, by its terms, meets all of the following requirements:

- (a) the stock appreciation right will expire no later than the Incentive Option;
- (b) the stock appreciation right may be for no more than the difference between the option price of the Incentive Option and the fair market value of the shares subject to the Incentive Option at the time the stock appreciation right is exercised;
- (c) the stock appreciation right is transferable only when the Incentive Option is transferable, and under the same conditions;
- (d) the stock appreciation right may be exercised only when the Incentive Option is eligible to be exercised; and
- (e) the stock appreciation right may be exercised only when the fair market value of the shares subject to the Incentive Option exceeds the option price of the Incentive Option.

Upon exercise of a stock appreciation right, a Participant shall be entitled to receive, without payment to the Corporation (except for applicable withholding taxes), an amount equal to the excess of or, in the Discretion of the Committee, a portion of the excess of (i) the then aggregate fair market value of the number of shares with respect to which the Participant exercises the stock appreciation right, over (ii) the aggregate fair market value of such number of shares at the time the stock appreciation right was granted. This amount shall be payable by the Corporation, in the Discretion of the Committee, in cash, in shares of Common Stock of the Corporation, in other property or any combination thereof.

13. Granting and Exercise of Stock Options and Stock Appreciation Rights. Subject to the provisions of this Paragraph 13, each stock option and stock appreciation right granted hereunder shall be exercisable at any such time or times or in any such installments as may be determined by the Committee and set forth in the written grant agreement. To the extent that the aggregate fair market value of shares (determined at the date such option was granted) with respect to which options designated as Incentive Options first become exercisable by a Participant in any calendar year (under this Plan and any other plan or agreement of the Company or any affiliate) exceeds \$100,000 (or such other amount as may be specified in Section 422 of the Code), such excess options shall be treated as Nonqualified Options. A Participant may exercise a stock option or stock appreciation right, if then exercisable, in whole or in part, by delivery to the Corporation of written notice of the exercise, in such form as the Committee may prescribe, accompanied, in the case of a stock option, by payment for the shares with respect to which the stock option is exercised as provided in Paragraph 11 (unless the Committee, in its Discretion, permits a cashless form of option exercise permitted by Paragraph 11). Except as provided in Paragraph 17 or an applicable written grant agreement, stock options and stock appreciation rights may be exercised only while the Participant is an employee, outside director, consultant or advisor, as the case may be, of the Corporation or a Subsidiary. Successive stock options and stock appreciation rights may be granted to the same Participant, whether or not the stock option(s) and stock appreciation right(s) previously granted to such Participant remain unexercised. A Participant may exercise a stock option or stock appreciation right, if then exercisable, notwithstanding that stock options and stock appreciation rights previously granted to such Participant remain unexercised.

14. Non-transferability of Stock Options and Stock Appreciation Rights. No stock option or stock appreciation right granted under the Plan to a Participant shall be transferable by such Participant otherwise than by will, or by the laws of descent and distribution, and stock options and stock appreciation rights shall be exercisable, during the lifetime of the Participant, only by the Participant. Notwithstanding the foregoing, in its Discretion and subject to such terms and conditions as it may prescribe, the Committee may permit a Participant to transfer a Nonqualified Option or a related or independently granted stock appreciation right.

15. Term of Stock Options and Stock Appreciation Rights. If not sooner terminated, each stock option and stock appreciation right granted hereunder shall expire not more than ten (10) years from the date of the granting thereof; provided, however, that with respect to an Incentive Option granted to a Participant who, at the time of the grant, owns (after applying the attribution rules of Section 424(d) of the Code) more than 10% of the total combined voting stock of all classes of stock of the Corporation or any parent or Subsidiary, such option shall expire not more than five (5) years after the date of granting thereof.

16. Continuation of Employment. The Committee may require, in its Discretion, that any Participant under the Plan to whom a stock option or a stock appreciation right shall be granted shall agree in writing as a condition of the granting of such stock option or stock appreciation right to remain an employee, consultant, advisor or outside

director of the Corporation or a Subsidiary, as the case may be, for a designated minimum period from the date of the granting of such stock option or stock appreciation right as shall be fixed by the Committee, and the Committee may further require, in its Discretion, that any Participant agree in writing to comply with any confidentiality, non-solicitation, non-competition and non-disparagement provisions and covenants that the Committee may require as a condition precedent to the exercise of a stock option or a stock appreciation right.

17. Termination of Employment. Except as set forth in an applicable grant agreement, if the employment of an employee Participant terminates, if the consultancy or advisorship of a consultant or advisor Participant terminates, or if an outside director Participant ceases to be a director (hereinafter collectively referred to as a “termination of employment”), the Committee may, in its Discretion, permit the exercise of stock options and stock appreciation rights granted to such Participant (a) for a period not to exceed three months following such termination of employment (or one year following termination of employment on account of the Participant’s death or permanent disability) with respect to Incentive Options or related stock appreciation rights, in either case, not to extend beyond the expiration date with respect to such options or stock appreciation rights, and (b) for a period not to extend beyond the expiration date with respect to Nonqualified Options or related or independently granted stock appreciation rights. A stock option or stock appreciation right may only be exercised after a Participant’s termination of employment to the extent exercisable on the date of termination of employment; provided, however, that if the termination of employment is due to the Participant’s death, permanent disability or retirement at a retirement age permitted under the Corporation’s or Subsidiary’s retirement plan or policies or as otherwise determined by the Committee, or if the termination of employment results from action by the Corporation or a Subsidiary without cause or from an agreement between the Corporation or a Subsidiary and the Participant (hereinafter collectively referred to as a “qualifying termination of employment”), the Committee, in its Discretion, may permit all or part of the stock options and stock appreciation rights granted to such Participant to thereupon become exercisable in full or in part. For purposes of this Paragraph 17 and any other provision of the Plan where the term is used, the Committee’s definition of “cause” shall be final and conclusive.

18. Restricted Stock or Restricted Stock Units. Subject to the terms of the Plan, the Committee may award Participants shares of restricted stock and/or the Committee may grant Participants restricted stock units with respect to a specified number of shares of stock. All shares of restricted stock and all restricted stock units granted to Participants under the Plan shall be subject to the following terms and conditions (and to such other terms and conditions prescribed by the Committee):

(a) At the time of each award of restricted stock or restricted stock units, there shall be established for the shares or units a restricted period, which period may differ among Participants and may have different expiration dates with respect to portions of shares or units covered by the same award. Notwithstanding the foregoing, and excluding awards granted under Section 18(i) below, unless the Committee determines otherwise with respect to any applicable Award, (i) the restricted period for non-performance-based restricted stock awards shall not be less than two years; provided that such condition shall be met if there are varying restricted periods within any award of non-performance-based restricted stock and the average restricted period for such non-performance-based restricted stock is not less than two years, and (ii) the restricted period for performance-based restricted stock awards shall not be less than one year.

(b) Unless otherwise provided in the written grant agreement, shares of restricted stock or restricted stock units granted to a Participant may not be sold, assigned, transferred, pledged, hypothecated or otherwise encumbered during the restricted period applicable to such shares or units. Except for such restrictions on transfer, a Participant may be provided all of the rights of a shareholder in respect of shares of restricted stock including, but not limited to, the right to receive dividends on, and the right to vote, the shares. All dividends, if any, received by a Participant with respect to shares of restricted stock, shall be subject to the restrictions applicable to the original Award. If any such dividends are paid in cash, such dividends shall be accumulated during the restricted period (without interest) and paid or forfeited when the shares of restricted stock vest or are forfeited, and in no event shall any cash dividends be paid later than 2-1/2 months after the end of the tax year in which the applicable restricted period ends. A Participant shall have no ownership interest in shares of stock with respect to which restricted stock units are granted; provided, however, that the Committee may, in its Discretion, permit payment to such Participant of dividend equivalents on such units equal to the amount of dividends, if any, which are paid on that number of shares with respect to which the restricted stock units are granted. Any dividend equivalent rights granted to a Participant shall be subject to the restrictions applicable to the original Award, and shall be paid in a manner that either complies with, or is exempt from, Section 409A of the Code.

(c) Unless otherwise provided in the written grant agreement, if there is a termination of employment of a Participant, all shares or units granted to the Participant which are still subject to the restrictions imposed by Paragraph 18(a) shall upon such termination of employment be forfeited and transferred back to the Corporation, without payment of any consideration by the Corporation; provided, however, that in the event of a qualifying termination of employment, the Committee may, in its Discretion, release some or all of the shares or units from the restrictions. In addition to or in lieu of conditioning the release of restrictions applicable to restricted stock or restricted stock units on the continued employment of the Participant for the restricted period applicable to the shares or units, the Committee may condition release of the restrictions on the attainment of one or more performance goals during the restricted period (hereinafter referred to as a "performance-based restricted stock or restricted stock unit award").

(d) The performance goal(s) applicable to a performance-based restricted stock or restricted stock unit award may be based upon any metric or criteria deemed appropriate by the Committee, including, without limitation, free cash flow, cash flow return on investment, stock price, market share, sales, revenues, earnings per share, return on equity, total shareholder return, costs, net income, working capital turnover, inventory or receivable turnover, margins and/or other objective financial results of the Corporation, a Subsidiary, or a division or unit thereof. The specific targets and other details of the performance goal(s) shall be established by the Committee, in its Discretion.

(e) Unless otherwise determined by the Committee in the case of a Participant who dies or becomes permanently disabled and subject to such other exceptions as the Committee may deem appropriate, the restrictions imposed by Paragraph 18(a) on restricted stock or restricted stock units subject to a performance-based goal shall lapse only after the attainment of the performance goal(s) during the restricted period. Unless otherwise determined by the Committee in its Discretion, if the performance goal(s) applicable to a performance-based restricted stock or restricted stock unit award has not been attained by the end of the restricted period, either in whole or in part, the shares or units subject to the award shall be forfeited and transferred back to the Corporation by the Participant, in whole or in part, as applicable (as required by the grant agreement), without payment of any consideration by the Corporation.

(f) Shares of restricted stock (including shares of performance based restricted stock) granted under the Plan may be evidenced in such manner as the Committee may deem appropriate, including, without limitation, book-entry registration or issuance of stock certificates. If stock certificates are issued in respect of shares of restricted stock, such certificates shall be registered in the name of the Participant, deposited with the Corporation or its designee, together with a stock power endorsed in blank, and, in the Discretion of the Committee, a legend shall be placed upon such certificates reflecting that the shares represented thereby are subject to restrictions against transfer and forfeiture.

(g) After the expiration of the restricted period applicable to restricted stock (and/or, in the case of performance-based restricted stock, after attainment of the applicable performance goal(s)), the Corporation shall deliver to the Participant or the legal representative of the Participant's estate stock certificates for such shares. If stock certificates were previously issued for the shares and a legend has been placed on such certificate, the Corporation shall cause such certificates to be reissued without the legend.

(h) After the expiration of the restricted period applicable to restricted stock units (and/or, in the case of performance-based restricted stock units, after attainment of the applicable performance goal(s)), the Corporation shall pay to the Participant an amount equal to the then fair market value of the shares to which the restricted stock units relate. In the Discretion of the Committee, such amount may be paid in cash, stock, other property or any combination thereof. Moreover, in the Discretion of the Committee, such amount may be paid in a lump sum or in installments, on a current or deferred basis, with provision for the payment or crediting of an additional amount on installment or deferred payments based upon a reasonable rate of interest or other rate of return specified by the Committee in its Discretion.

In the case of events such as stock dividends, stock splits, recapitalizations, mergers, consolidations or reorganizations of or by the Corporation any stock, securities or other property which a Participant receives or is entitled to receive by reason of his ownership of restricted stock (including performance-based restricted stock) shall, unless otherwise determined by the Committee, be subject to the same restrictions applicable to the restricted stock.

(i) Outside directors who are first elected or appointed to the Corporation's Board shall be granted automatically (without any action by the Committee or the Board) an award of a number of shares of restricted common stock equal to (i) \$4,167 (which amount may be modified from time to time by the Committee in its Discretion), multiplied by (ii) the number of full months between the date of such election or appointment and the first anniversary of the last completed annual meeting of the Corporation's shareholders, and divided by (iii) the closing price of the Corporation's common stock on the date of first election or appointment. In addition, on the date of each annual meeting of the Corporation's shareholders, each outside director then in office shall be granted automatically (without any action by the Committee or the Board) an award of a number of shares of restricted common stock equal to \$50,000 (which amount may be modified from time to time by the Committee in its Discretion) divided by the closing price of the Corporation's common stock on such date. The restricted period with respect to each share of restricted common stock granted under this paragraph shall lapse on the date of the annual meeting of shareholders held during the calendar year following the date of grant or, if earlier, on the first anniversary of the date of grant, in each case so long as the applicable director remains a director through such date. Restricted stock granted pursuant to this paragraph shall be forfeited and immediately returned to the Company if the applicable director ceases to be a director prior to the date the restrictions with respect to such restricted stock are to lapse, except that if an outside director's services as a member of the Board terminates because of (1) total disability (as determined by the Committee), (2) death (3) retirement on or after age 65 and after at least ten years of service as a member of the Board, or (4) any other circumstance that the Committee, in its Discretion, deems to be applicable, then all restrictions with respect to the restricted stock granted pursuant to this paragraph shall immediately lapse upon the occurrence of such event.

19. Performance Shares. The Committee may grant to a Participant the right to earn performance shares subject to the following terms and conditions:

(a) The Participant's right to earn performance shares shall be subject to attainment of one or more performance goals over a performance period prescribed by the Committee.

(b) The performance goal applicable to an award to a Participant of the right to earn performance shares may be based upon any metric or criteria the Committee deems appropriate, including, without limitation, free cash flow, cash flow return on investment, stock price, market share, sales, revenues, earnings per share, return on equity, total shareholder return, costs, net income, working capital turnover, inventory or receivable turnover margins and/or other objective financial results of the Corporation, a Subsidiary, or a division or unit thereof. The specific targets and other details of the performance goal shall be established by the Committee in its Discretion.

(c) Unless otherwise determined by the Committee in the case of a Participant who dies or becomes permanently disabled and subject to such other exceptions as may be deemed appropriate by the Committee, performance shares shall be issued to a Participant (in whole or in part, as applicable) only after expiration of the performance period and attainment of the performance goal applicable to the award.

(f) No Participant shall have any of the rights of a shareholder of the Corporation in respect of the shares covered by a performance share award until the actual issuance of the shares to said Participant and, prior to such issuance, no adjustments shall be made for dividends, distributions or other rights in respect of such shares, except as provided in Paragraph 5.

(g) In its Discretion and subject to such terms and conditions as it may impose, the Committee may permit a Participant to elect to defer receipt of performance shares to a time later than the time the shares otherwise would be issued to the Participant; provided that such deferral election complies with rules adopted by the Committee, which comply with, or are exempt from, the requirements of Section 409A of the Code. In such event, the Committee may, in its Discretion, provide for the payment by the Corporation of an additional amount representing interest at a reasonable rate or such other rate of return determined by the Committee in its Discretion.

(h) In the Discretion of the Committee, in lieu of settling a performance share award by issuance of shares of Common Stock of the Corporation to a Participant, all or a portion of the award may be settled by payment of cash or other property to the Participant in an amount or having a value equal to the then value of the otherwise issuable shares.

(i) Unless otherwise determined by the Committee, performance shares or rights therein awarded to a Participant may not be sold, assigned, transferred, pledged, hypothecated or otherwise encumbered by the Participant at any time before actual issuance of the shares to the Participant.

(j) In its Discretion, the Committee may subject a performance share award to a Participant to any other terms or conditions not inconsistent with the foregoing, including, without limitation, a requirement that the Participant remain an employee of the Corporation or a Subsidiary (including at or above a specified salary grade), or that the Participant remain a consultant, advisor or outside director of the Corporation or a Subsidiary, for the entire performance period applicable to the award.

20. Other Stock-Based Awards. The Committee may grant to Participants such other awards that are denominated or payable in, valued in whole or in part by reference to, or otherwise based on or related to, shares of Common Stock of the Corporation as are deemed by the Committee, in its Discretion, to be consistent with the purposes of the Plan; provided, however, that such grants must comply with applicable law. Without limitation, the Committee may permit a Participant to make a current, outright purchase of shares of Common Stock of the Corporation, which shares may or may not be subject to any restrictions or conditions, for a price equal to, less than or greater than the then fair market value of the shares, with the price payable by the Participant in such form and manner and at such time as determined by the Committee in its Discretion.

21. Investment purpose. If the Committee, in its Discretion, determines that as a matter of law such procedure is or may be desirable, it may require a Participant, upon any acquisition of stock hereunder and as a condition to the Corporation's obligation to deliver certificates representing such shares, to execute and deliver to the Corporation a written statement in form satisfactory to the Committee, representing and warranting that the Participant's acquisition of shares of stock shall be for such person's own account, for investment and not with a view to the resale or distribution thereof and that any subsequent offer for sale or sale of any such shares shall be made either pursuant to (a) a Registration Statement on an appropriate form under the Securities Act of 1933, as amended (the "Securities Act"), which Registration Statement has become effective and is current with respect to the shares being offered and sold, or (b) a specific exemption from the registration requirements of the Securities Act, but in claiming such exemption the Participant shall, prior to any offer for sale or sale of such shares, obtain a favorable written opinion from counsel for or approved by the Corporation as to the availability of such exemption. The Corporation may endorse an appropriate legend referring to the foregoing restriction upon the certificate or certificates representing any shares issued or transferred to the Participant under the Plan.

22. Rights to Continued Employment. Nothing contained in the Plan or in any Award granted pursuant to the Plan, nor any action taken by the Committee hereunder, shall confer upon any Participant any right with respect to continuation of employment or service as an employee, consultant, advisor or outside director of the Corporation or a Subsidiary nor interfere in any way with the right of the Corporation or a Subsidiary to terminate such person's employment or service at any time with or without cause.

23. Withholding Payments. If, upon the grant, exercise, release of restrictions or settlement of or in respect of an Award, or upon any other event or transaction under or relating to the Plan, there shall be payable by the Corporation or a Subsidiary any amount for income or employment tax withholding, in the Committee's Discretion, either the Corporation shall appropriately reduce the amount of stock, cash or other property to be paid to the Participant or the Participant shall pay such amount to the Corporation or Subsidiary to enable it to pay or to reimburse it for paying such income or employment tax withholding. The Committee may, in its Discretion, permit Participants to satisfy such withholding obligations, in whole or in part, by electing to have the amount of Common Stock delivered or deliverable by the Corporation in respect of an Award appropriately reduced, or by electing to tender Common Stock back to the Corporation subsequent to receipt of such stock in respect of an Award. The Corporation or any of its Subsidiaries shall also have the right to withhold the amount of such taxes from any other sums or property due or to become due from the Corporation or any of its Subsidiaries to the Participant upon such terms and conditions as the Committee shall prescribe. The Corporation may also defer issuance of stock under the Plan until payment by the Participant to the Corporation or any of its Subsidiaries of the amount of any such tax. In the case of a Regulation T Stock Option Exercise, the Committee may in its Discretion permit the Participant to irrevocably instruct a stock broker to promptly deliver to the Corporation an amount (in addition to the option exercise price) equal to any withholding tax owing in respect of such option exercise from the proceeds of the stock broker's sale of or loan against some or all of the shares.

24. Change in Control. Notwithstanding any other provision of the Plan or any provision of a grant agreement, in the event the Committee determines that there has been or will be a Change in Control (as such term is defined below) of the Corporation, the Committee may, without the consent of the holder, provide for any treatment of outstanding Awards which it determines, in its Discretion, to be appropriate. Such treatment may (but not automatically) include, without limitation, acceleration of vesting of stock options and stock appreciation rights, release of restrictions applicable to restricted stock or restricted stock units, or deeming performance share awards and performance-based restricted stock and restricted stock unit awards to have been earned.

For purposes of the Plan, a “Change in Control” means any of the following: (a) the consummation of a merger, consolidation or reorganization involving the Corporation, unless securities representing more than fifty percent (50%) of the total combined voting power of the voting securities of the successor corporation are immediately thereafter beneficially owned, directly or indirectly and in substantially the same proportion, by the persons who beneficially owned the Corporation’s outstanding voting securities immediately prior to such transaction; (b) the consummation of a transfer, sale or other disposition, in one or a series of related transactions, of all or substantially all of the Corporation’s assets to any individual entity or group (a “Person”) (other than any Person that is directly controlled by or under common control with the Corporation); (c) the consummation of an acquisition, directly or indirectly, by any Person (other than the Corporation or any Person that is directly controlled by or under common control with the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the Securities Exchange Act of 1934, as amended) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation’s outstanding securities; (d) individuals who, as of the date hereof, constitute the Board (the “Incumbent Board”) cease for any reason to constitute at least a majority of the Board; provided that, any individual who becomes a director of the Corporation subsequent to the date hereof whose election, or nomination for election, by the Corporation’s shareholders was approved by the vote of at least a majority of the Independent Directors (as defined by applicable Nasdaq listing standards or, if the Corporation ceases to be listed on The Nasdaq Stock Market and is instead listed on another stock exchange, then as defined by the applicable rules of such other stock exchange) then comprising the Incumbent Board shall be deemed a member of the Incumbent Board; or (e) the consummation of a complete liquidation or dissolution of the Corporation. In no event, however, shall a Change in Control be deemed to occur in connection with (a) a merger or reorganization of the Corporation, the sole purpose of which is to reincorporate the Corporation in a different state, or (b) any public offering of stock, the primary purpose of which is to raise additional capital.

25. Prohibition on Repricing. Except in connection with a corporate transaction involving the Corporation (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of outstanding Awards may not be amended to reduce the exercise price of outstanding stock options or stock appreciation rights or cancel outstanding stock options or stock appreciation rights in exchange for cash, other Awards or stock options or stock appreciation rights with an exercise price that is less than the exercise price of the original stock options or stock appreciation rights without shareholder approval.

26. Effectiveness of Plan. The Plan shall be effective on the date the shareholders approve the Plan, subject to adoption by the Board if adoption had not already occurred prior to such shareholder approval. Awards may not be granted prior to shareholder approval of the Plan.

27. Termination, Duration and Amendments of Plan. The Plan may be abandoned or terminated at any time by the Board. Unless sooner terminated by the Board, the Plan shall terminate on the date ten (10) years after its approval by the shareholders, and no Awards may be granted thereafter. The termination of the Plan shall not affect the validity of any Award outstanding on the date of termination.

For the purpose of conforming to any changes in applicable law or governmental regulations, or for any other lawful purpose, the Board shall have the right, without approval of the shareholders of the Corporation, to amend or revise the terms of the Plan at any time; provided however, that no such amendment or revision shall (i) increase the maximum number of shares in the aggregate which are subject to the Plan (subject, however, to the provisions of Paragraph 5), materially change the class of persons eligible to be Participants under the Plan, or materially increase the benefits accruing to Participants under the Plan, without approval or ratification of the shareholders of the Corporation; or (ii) with respect to an Award previously granted under the Plan, except as otherwise specifically provided in the Plan, adversely affect the rights granted under any such Award without the consent of the holder thereof.

28. Section 409A of the Code. It is intended that Awards granted under the Plan either be exempt from, or comply with, the requirements of Section 409A of the Code and the guidance and regulations issued thereunder and, accordingly, to the maximum extent permitted, the Plan and agreements granting Awards shall be interpreted consistent with such intent. In the event that any Award is subject to but fails to comply with Section 409A of the Code, the Corporation may revise the terms of the grant to correct such noncompliance to the extent permitted under any guidance, procedure or other method promulgated by the Internal Revenue Service now or in the future or otherwise available that provides for such correction as a means to avoid or mitigate any taxes, interest or penalties that would otherwise be incurred by the Participant on account of such noncompliance; provided, however, that in no event whatsoever shall the Corporation be liable for any additional tax, interest or penalty imposed upon or other detriment suffered by a Participant under Code Section 409A or damages for failing to comply with Section 409A of the Code. Notwithstanding anything to the contrary contained herein or in any agreement pertaining to an Award, the payment or settlement of any 409A Award that would otherwise be payable or distributable upon the occurrence of a Change in Control, the Participant's disability or termination of employment, shall not be payable or distributable to the Participant by reason of such circumstance unless (i) the circumstances giving rise to such event also constitutes a change in control within the meaning of Treas. Reg. §1.409A-3(i)(5), a disability within the meaning of Treas. Reg. §1.409A-3(i)(4), or a "separation from service" within the meaning of Treas. Reg. §1.409A-1(h), respectively, or (ii) the payment or distribution of such amount or benefit would be exempt from the application of Section 409A of the Code by reason of the short-term deferral exemption or otherwise. This provision does not prohibit the vesting of any Award. If this provision prevents the payment or distribution of any amount or benefit, such payment or distribution shall be made on the next earliest payment or distribution date or event specified in the grant agreement that is permissible under Section 409A of the Code. Notwithstanding anything else to the contrary in the Plan, to the extent that a Participant is a "specified employee" (as determined in accordance with the requirements of Section 409A of the Code), no payment on account of a Participant's separation from service (determined in accordance with Treas. Reg. §1.409A-1(h)) in settlement of a 409A Award may be made before the date which is six months after such Participant's date of separation from service, or, if earlier, the date of the Participant's death.

29. General.

(a) The granting of Awards and the issuance of shares of Common Stock hereunder shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies as may be required. No shares of Common stock shall be issued or transferred pursuant to this Plan unless and until all legal requirements applicable to such issuance or transfer have, in the opinion of counsel to the Corporation, been complied with. In connection with any such issuance or transfer, the person acquiring the shares shall, if requested by the Corporation, give assurances satisfactory to counsel to the Corporation in respect to such matters as the Corporation may deem desirable to assure compliance with all applicable legal requirements.

(b) Neither the adoption of the Plan nor the submission of the Plan to the Corporation's shareholders for approval shall be construed as creating any limitations upon the right and authority of the Board to adopt such other incentive compensation arrangements (which arrangements may be applicable either generally to a class or classes of individuals or specifically to a particular individual or particular individuals) as the Board in its discretion determines desirable, including, without limitation, the granting of options otherwise than under the Plan.

(c) Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of Participant's compensation for purposes of determining the Participant's benefits under any other benefit plans or arrangements provided by the Corporation or any affiliate, except where the Committee expressly provides otherwise in writing.

(d) Notwithstanding any other provision of this Plan (or of any other agreement, contract, or understanding heretofore or hereafter entered into by a Participant with the Corporation or any affiliate, except an agreement, contract, or understanding hereafter entered into that expressly modifies or excludes application of this paragraph (an "Other Agreement"), and notwithstanding any formal or informal plan or other arrangement for the direct or indirect provision of compensation to the Participant (including groups or classes of Participants or beneficiaries of which the Participant is a member), whether or not such compensation is deferred, is in cash, or is in the form of a benefit to or for the Participant (a "Benefit Arrangement"), if the Participant is a "disqualified individual," as defined in Section 280G(c) of the Code, any options, stock appreciation rights, restricted stock, restricted stock units, performance shares or units or other Awards hereunder held by that Participant and any right to receive any

payment or other benefit under this Plan shall not become exercisable or vested (i) to the extent that such right to exercise, vesting, payment, or benefit, taking into account all other rights, payments, or benefits to or for the Participant under this Plan, all Other Agreements, and all Benefit Arrangements, would cause any payment or benefit to the Participant under this Plan to be considered a “parachute payment” within the meaning of Section 280G(b)(2) of the Code as then in effect (a “Parachute Payment”) and (ii) if, as a result of receiving a Parachute Payment, the aggregate after-tax amounts received by the Participant from the Corporation under this Plan, all Other Agreements, and all Benefit Arrangements would be less than the maximum after-tax amount that could be received by the Participant without causing any such payment or benefit to be considered a Parachute Payment. In the event that the receipt of any such right to exercise, vesting, payment, or benefit under this Plan, in conjunction with all other rights, payments, or benefits to or for the Participant under any Other Agreement or any Benefit Arrangement would cause the Participant to be considered to have received a Parachute Payment under this Plan that would have the effect of decreasing the after-tax amount received by the Participant as described in clause (ii) of the preceding sentence, those rights, payments, or benefits under this Plan, any Other Agreements, and any Benefit Arrangements that are to be reduced or eliminated so as to avoid having the payment or benefit to the Participant under this Plan be deemed to be a Parachute Payment shall be determined in the following order and priority: first, there shall be reduced or eliminated any such right, payment or benefit that is excluded from the coverage of Section 409A of the Code, and then there shall be reduced or eliminated any such right, payment or benefit that is subject to Code Section 409A (with the reduction in rights, payments or benefits subject to Code Section 409A occurring in the reverse chronological order in which such rights, payments or benefits would otherwise be or become vested, exercisable or settled).

(e) The interests of any Participant under the Plan or any Award shall not be subject to the claims of creditors and may not, in any way, be assigned, alienated, or encumbered.

(f) The Plan, and all Awards made pursuant hereto, shall be governed, construed, and administered in accordance with and governed by the laws of the State of Michigan (regardless of the laws that might otherwise govern under applicable principles of conflicts of laws of such jurisdiction or any other jurisdiction).

(g) It is the intent of the Corporation that Awards and transactions permitted by Awards be interpreted in a manner that, in the case of Participants who are or may be subject to Section 16 of the Exchange Act, qualify, to the maximum extent compatible with the express terms of the Awards, for the exemption from liability provided in Rule 16b-3 promulgated under the Exchange Act. The Corporation shall have no liability to any Participant or other person for Section 16 consequences of Awards or events in connection with Awards if an Award or related event does not so qualify.

(h) References in the Plan to any law, rule or regulation shall include a reference to any corresponding rule (or number redesignation) of any amendments or restatements to such law, rule or regulation adopted after the effective date of the Plan’s adoption.

(i) Headings are given to the sections and subsections of the Plan solely as a convenience to facilitate reference. Such headings shall not be deemed in any way material or relevant to the construction or interpretation of the Plan or any provision thereof.

(j) In the event that any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

(k) Nothing contained in the Plan shall be construed to limit the authority of the Corporation to exercise its corporate rights and powers, including but not by way of limitation, the right of the Corporation to grant or issue options for proper corporate purposes other than under the Plan with respect to any employee or other person, firm, corporation, or association.

(l) This document is a complete statement of the Plan.

CERTIFICATION

I, Phillip Eyler, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gentherm Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Phillip Eyler

Phillip Eyler

President & Chief Executive Officer

July 31, 2018

CERTIFICATION

I, Barry G. Steele, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gentherm Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Barry G. Steele

Barry G. Steele
Chief Financial Officer
July 31, 2018

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Gentherm Incorporated (the "Company") on Form 10-Q for the period ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Phillip Eyler, President & Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1). The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2). The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Phillip Eyler

Phillip Eyler
President & Chief Executive Officer
July 31, 2018

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Gentherm Incorporated (the "Company") on Form 10-Q for the period ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Barry G. Steele, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1). The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2). The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Barry G. Steele

Barry G. Steele
Chief Financial Officer
July 31, 2018