Gentex Corporation

NasdaqGS:GNTX

Analyst: Maxime Lattanzio
Sector: Consumer Disc.

BUY

Price Target: $22.73

Key Statistics as of 12/09/2016

Market Price:	$19.90
Industry:	Auto Components
Market Cap:	$5.701B
52-Week Range:	$12.93-$20.00
Beta:	1.08

Catalysts:

- Short-term: Q4 2016 Earnings
- Mid-term: Penetration of new markets such as China
- Mid/long-term: sustaining growth of new products while maintaining current margins

Company Description:

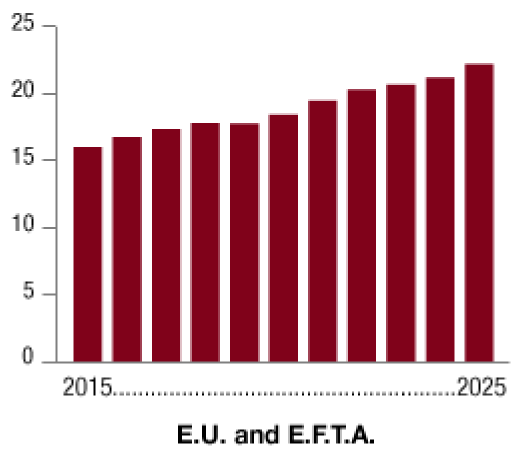
Gentex Corporation is a producer of auto-dimming rear-view mirrors and diverse driving assistance systems for automobiles. It also manufactures smoke alarms and windows for airplanes. The company was established in 1974, and is currently headquartered in Zeeland, Michigan. Most of its revenue (98% on average) comes from automotive products that the company supplies to all major car manufacturers around the world, and especially in the United States, Germany, and Japan. The company's average trading volume is around 2.1 million shares.

Thesis

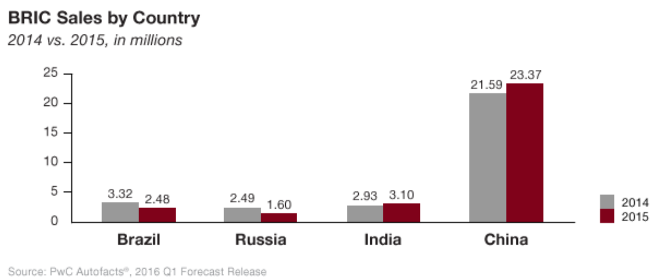
- Gentex already is the global leader in production of auto-dimming mirrors for automobiles, and has opportunity to further penetrate markets with tremendous growth potential.
- Diversification through the acquisition of HomeLink is offering even more potential for growth.
- As the company has been applying strict financial discipline, gross margins have significantly improved and are likely to remain around 40%, which is currently the company's historical high.

Industry Outlook

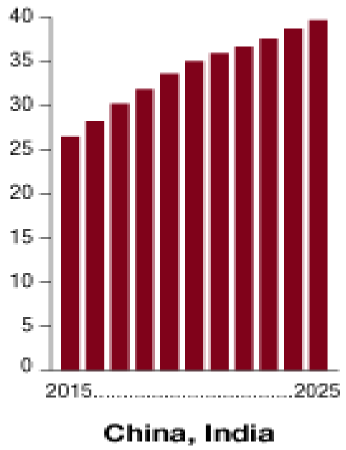
As Gentex provides products for automobiles, its revenue growth highly depends on the general automotive industry well-being. After reaching historical highs worldwide in the next year, mainly thanks to rapid growth in China and India, the market for automobiles is expected to keep on growing at a fast rate in the next decade.



Even though sales in the United States and in Japan are expected to remain steady but relatively flat over the next decade, European sales are expected to grow more significantly over the same period, as shown by the above graph from PwC, from 16 million units in 2015 to more than 22 million by 2025.



When it comes to emerging markets, data shows that most of the growth in sales is due to China, as the volume of sales in 2015 was as much as 23.37 million units, and the sole growth in sales that year (+1.8 million) was more than three times as big as the whole South African market for the same period. Plus, China and India, thanks to their populations higher than 1 billion each, have strong growth opportunities, as the economies are developing at a fast pace. The automotive market for both these countries combined is expected to grow by around 60% by 2025.



Finally, when looking back at America, which represents a third of Gentex's sales, in spite of the flat outlook for the coming years, the election of Donald Trump might lead to a lower regulatory burden, lower corporate taxed, and increased spending, contributing to benefit the automotive industry within the country.

Leader in rearview mirrors

Gentex, even though it has a strong product mix, with auto-dimming mirrors, HomeLink module, aerospace products, and fire safety products, mainly relies on the success of its automotive products, and especially rearview mirrors, to generate revenue. As a matter of fact, 86.3% of the company's total revenue was attributable to sale of rearview mirrors. Even if this number is down from 2012 97.9% due to the acquisition of HomeLink in late 2013, this is still the main source of sales for Gentex. For these rearview mirrors, Gentex is no less than the main supplier of most of the biggest car companies. Its four biggest clients are Volkswagen, Toyota, Ford, and General Motors but most of the biggest automobile producers around the world purchase Gentex products. Furthermore, the company ensures it maintains strong business relationship with its four main customers, it cooperates with them in the development of new products and mirrors to become the OEM (Original Equipment Manufacturer) on these companies end products.

The acquisition of HomeLink in 2013 was designed to make the automotive products even more complete and attractive for buyers. Thanks to the HomeLink module, drivers can control their garage door, security systems, and even indoor and outdoor lightning by using buttons on their inside rearview mirrors.

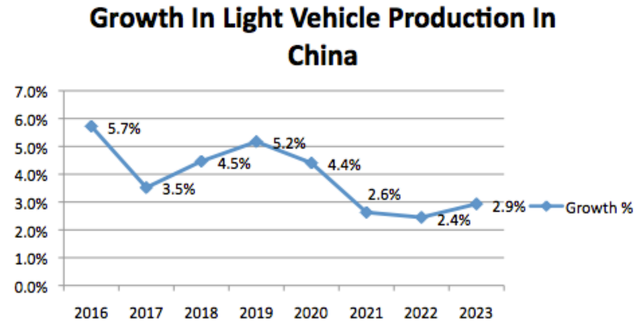
In Millions of USD except Per Share	FY 2012		FY 2013		FY 2014		FY 2015	
12 Months Ending	12/31/2012		12/31/2013		12/31/2014		12/31/2015	
Revenue	1,099.6	100.0%	1,171.9	100.0%	1,375.5	100.0%	1,543.6	100.0%
Automotive Products	1,077.0	97.9%	1,144.0	97.6%	1,340.1	97.4%	1,506.9	97.6%
Automotive Mirrors	–		1,108.1	94.6%	1,169.4	85.0%	1,332.8	86.3%
HomeLink Modules	–		35.9	3.1%	170.7	12.4%	174.1	11.3%
Fire Protection Products	22.6	2.1%	27.9	2.4%	35.4	2.6%	36.7	2.4%

Overall, over the last 3 years, the company has been sustaining strong revenue growth with 12.0% CAGR over the last three years, while the mirrors revenue grew by 7.4% over the same period. Gentex has managed to maintain double-digit growth level over the past years, and now has even more opportunities to maintain, if not improve, this growth by penetrating better some markets.

Penetration of European and Chinese markets

As explained before, Gentex is a leading producer of rearview mirrors for car companies, and as OEM for its main customers, has fully penetrated some markets like United States, Germany, or Japan, but still has room to grow in other markets, and has given guidance to show it is willing to exploit these opportunities. First, as they declared in their Q3 2016 earning call, Europe is around 40% penetrated, and the company is willing to penetrate further this market in the future, which is likely to generate further revenue growth from this region.

Then, the biggest opportunity is the Chinese market. As detailed in the first paragraph, the Chinese market has become one of the biggest on earth, with more than 23 million cars sold per year. More importantly, as the economy of the country is growing, more and more people are purchasing cars, which is leading to a growing market. According to the below forecast, the market for light vehicles will be growing for the next 8 years, and will grow around 4.5% average until 2020.



Furthermore, Gentex executives estimate the Chinese market has only been penetrated at 15% of its potential by the company. To remediate it and gain market shares in this market, the company is willing to put the necessary resources. As the market is still in development, it will be easy for Gentex to implement its products given its reputation, but, as stated by Steve Downing, CFO of the company, during the last earnings call, the constraint is "the selling and creating the business case for the OEM on why it is a necessity". The company has started to take the necessary steps for it to happen, and there are currently OEMs that will start production with HomeLink in China starting next year. This will likely allow Gentex to benefit from the huge opportunity that China is, and revenues will grow accordingly.

Profitability

While the company has been sustaining strong growth compared to the auto components industry, it has also managed to generate more profits out of every dollar of revenue than its peers.

	Name (BI Peers)	Sales Growth 1 Year	Gross Margin	Operating Margin	Profit Margin	Return on Assets	Return on Equity
	Average	4.35%	21.88%	10.21%	6.95%	7.04%	19.18%
100)	GENTEX CORP	12.22%	39.11%	29.72%	20.87%	15.85%	19.69%

Given the strong automation of the production of products, the company has a strong fixed cost basis, and it needs to sustain high single digit to low double digit revenue growth if it wants to maintain optimal profitability.

12 Months Ending	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Revenue, Adj	1,099.6	1,171.9	1,375.5	1,543.6
Growth %, YoY	7.4	6.6	17.4	12.2
Gross Profit, Adj	372.8	430.7	538.9	603.8
Margin %	33.9	36.8	39.2	39.1
EBITDA, Adj	289.6	370.9	476.2	539.4
Margin %	26.3	31.7	34.6	34.9
Net Income, Adj	171.8	225.1	288.6	318.5
Margin %	15.6	19.2	21.0	20.6

As shown on the previous table, in the recent past, whenever the revenue growth dropped in the mid-single digit range, profitability started to decline, and EBITDA margin even fell below 30%, and net margin below 20%.
However, three things are to be noted. First, even in times of lower revenue growth that led to pressures on profits (FY 2012 and 2013), all margins, from gross margin to net margin, still remained better than the average in the industry. Then, given the potential for growth thanks to HomeLink acquisition, China and Europe expansion, and strong OEMs, the company is likely to maintain high margins, around the 39% gross margin it reached in the last quarter, which is Gentex's long term objective. Finally, the company is directing its production of new mirrors towards more advanced features that generate better margins.

Financials and Multiples

Capitalization (Debt/Equity)			WACC		
	History	*LFY*		*History*	*LFY*
GNTX	0.05	0.04	GNTX	12.6%	11.1%
Competitors	0.24	0.30	Competitors	15.6%	13.2%

Financially, Gentex is being conservative and has almost no debt. Therefore, in addition to borrowing at a low rate (current cost of debt of its Long Term debt portion is 2.2% after tax), the company is financially safe, with a debt to equity ratio of 0.04, which is 7 times lower than the industry. Therefore, the WACC of the company has historically been significantly lower than the average for the industry.

ROIC W/O GW			ROIC /WACC		
	History	*LFY*		*History*	*LFY*
GNTX	25.2%	25.4%	GNTX	1.83	1.91
Competitors	18.3%	21%	Competitors	0.96	1.29

As the company has historically been generating high margins, its ROIC has been 7% higher than the average. Over the last year, even though the industry improved, Gentex still remained far ahead of its peers. Historically, even when the industry destroyed value (ROIC/WACC below 1), Gentex managed to generate value with a ratio of 1.83. Given the financial discipline and cost efficiency the company has had and wants to maintain, the above average value creation will probably continue in the future.

When it comes to multiples, even if the company is having P/E and EV/EBITDA ratios that are relatively in line with the industry, Gentex is currently trading around its 4-year low P/E, and near its 3-year low EV/EBITDA. According to the company's historical ratios, it is currently underpriced.

Future Dates and Catalysts

In the future, some events are going to be under scrutiny by investors, and are likely to budge the stock price significantly. In the next months, the earnings announcement coming in January will give the full picture of the company's performance in 2016, and will be watched by investors that have high expectations regarding the company's results for this year.

Then, in the next year, the company's ability to actually penetrate better the Chinese market thanks to the potential of HomeLink module while managing to obtain Original Equipment Manufacturer contract that ensure a significant amount of revenue given the size of the market will be a major stock price mover.

Finally, in the long run, one of the main movers of the stock price will be the ability of the company to maintain its current revenue growth, as it is also the main driver of the company's profitability.

Summary

In conclusion, Gentex Corporation is a safe investment that can bring solid return on investment. Thanks to its financial stability, as well as its OEM contracts, the company shows a low level of risk on both financial leverage and revenue generation grounds. Furthermore, executives know what opportunities to look for, and by trying to drive their product mix towards higher margin-generating products while investing in implementation in fastest growing markets, they increase the likelihood of future success of the company.

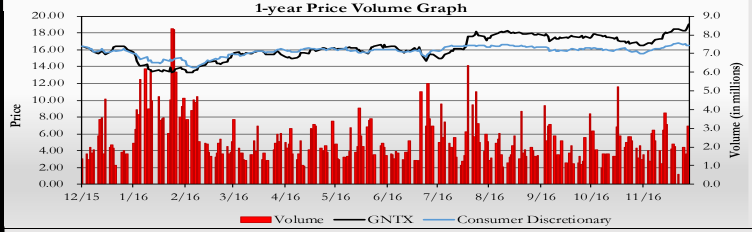
In addition to this, Trump's arrival into office in January may mean lower corporate taxes and regulations in the United States, which would bring improved results for Gentex, as US sales currently represent 33% of the company's revenue.

All these factors that set the ground for capital appreciation, coupled to the 2% dividend yield the company distributed, make Gentex a safe investment with above 20% potential return over the next year.

Siena Market Line
2nd week of December 2016

Gentex Corporation (GNTX) — CENTER FOR GLOBAL FINANCIAL STUDIES — BULLISH

Analysis by Maxime Lattanzio	Current Price:	$18.63	Intrinsic Value	$17.72	Target 1 year Return: 24.03%
12/4/2016	Divident Yield:	2.0%	Target Price	$22.73	Probability of Price Increase: 99.8%



Description

Gentex Corporation designs, develops, manufactures, and markets automatic-dimming rearview mirrors and electronics for the automotive industry; dimmable aircraft windows for the aviation industry; and commercial smoke alarms and signaling devices for the fire protection industry worldwide.

General Information

Sector	Consumer Discretionary
Industry	Auto Components
Last Guidance	November 3, 2015
Next earnings date	January 28, 2017
Estimated Country Risk Premium	7.90%
Effective Tax rate	32%
Effective Operating Tax rate	35%

Market Data

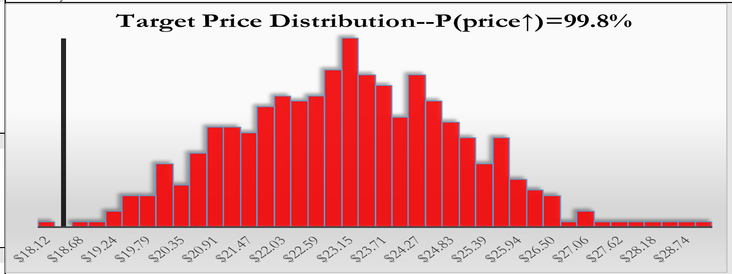
Market Capitalization	$5,337.67
Daily volume (mil)	2.07
Shares outstanding (mil)	286.51
Diluted shares outstanding (mil)	291.76
% shares held by institutions	88%
% shares held by investments Managers	76%
% shares held by hedge funds	2%
% shares held by insiders	2.06%
Short interest	8.02%
Days to cover short interest	11.08
52 week high	$19.00
52-week low	$12.93
Levered Beta	1.08
Volatility	30.38%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
9/30/2015	-3.72%	-1.29%
12/31/2015	2.42%	1.84%
3/31/2016	-2.67%	-1.79%
6/30/2016	-1.05%	0.73%
9/30/2016	-1.16%	1.93%
Mean	-1.24%	0.28%
Standard error	1.0%	0.8%

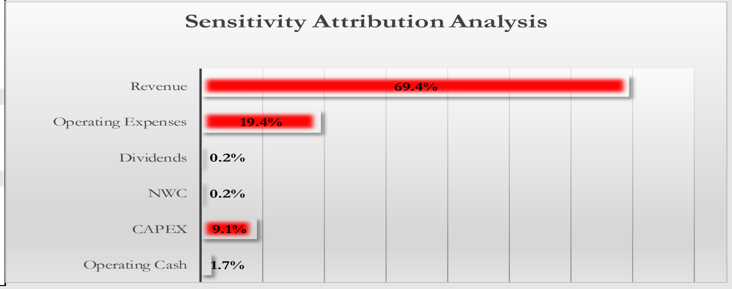
Peers

Tower International, Inc.
Superior Industries International, Inc.
Visteon Corporation
Gentherm Incorporated
BorgWarner Inc.
American Axle & Manufacturing Holdings, Inc.
Standard Motor Products, Inc.
Dana Incorporated

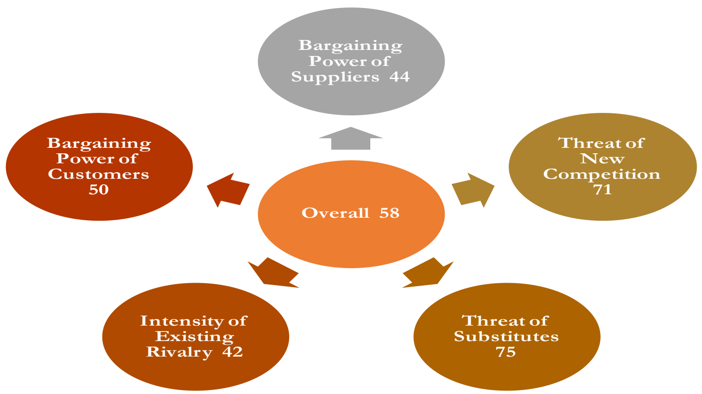


Management	Position	Total compensations growth	Total return to shareholders
Bauer, Fred	Founder, Executive Chairman	4.05% per annum over 5y	-0.81% per annum over 5y
Downing, Steven	Chief Financial Officer and	10.32% per annum over 2y	0.45% per annum over 2y
Nash, Kevin	Chief Accounting Officer and	-9.46% per annum over 1y	-9.49% per annum over 1y
Ryan, Scott	Assistant General Counsel an	N/M	0% per annum over 0y
Matthews, Joseph	Vice President of Purchasing	-3.83% per annum over 1y	-9.49% per annum over 1y
Flynn, Paul	Vice President of Operations	-100% per annum over 1y	-9.49% per annum over 1y

Profitability	GNTX (LTM)	GNTX (5 years historical average)	Industry (LTM)
ROIC	22.5%	26.89%	14.61%
NOPAT Margin	22%	23.79%	8.3%
Revenue/Invested Capital	1.00	1.13	1.75
ROE	24.0%	26.20%	19.54%
Adjusted net margin	22%	23.71%	7.3%
Revenue/Adjusted Book Value	1.08	1.11	2.67
Invested Funds	**GNTX (LTM)**	**GNTX (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	26.6%	23.8%	8%
Estimated Operating Cash/Total Capital	20.7%	21.0%	N/A
Non-cash working Capital/Total Capital	10.4%	11.4%	13%
Invested Capital/Total Capital	68.1%	67.3%	90%
Capital Structure	**GNTX (LTM)**	**GNTX (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.04	0.04	0.45
Cost of Existing Debt	2.89%	1.27%	5.37%
Estimated Cost of new Borrowing	5.27%	5.34%	5.37%
CGFS Risk Rating	C	C	CC
Unlevered Beta (LTM)	1.05	1.21	1.14
WACC	12.08%	13.32%	12.02%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	11.8%	22.5%	1.86
9/30/2017	7.7%	23.9%	2.01
9/30/2018	7.5%	23.7%	1.96
9/30/2019	7.2%	23.9%	1.97
9/30/2020	6.8%	24.0%	1.99
9/30/2021	6.4%	24.2%	2.01
9/30/2022	6.0%	24.5%	2.06
9/30/2023	5.6%	24.9%	2.10
9/30/2024	5.2%	25.2%	2.14
9/30/2025	4.8%	25.5%	2.17
9/30/2026	4.4%	25.8%	2.21
Continuing Period	4.0%	26.1%	2.24

Period	Invested Capital	Net Claims	Price per share
Base Year	$967.76	$96.15	$17.33
9/30/2017	$1,120.07	-$154.19	$19.43
9/30/2018	$1,103.19	-$461.07	$21.68
9/30/2019	$1,414.21	-$791.72	$24.02
9/30/2020	$1,665.39	-$1,204.56	$26.64
9/30/2021	$1,760.97	-$1,580.81	$29.14
9/30/2022	$1,927.09	-$1,993.26	$31.75
9/30/2023	$2,064.27	-$2,444.65	$34.49
9/30/2024	$2,197.51	-$2,936.87	$37.35
9/30/2025	$2,325.39	-$3,472.96	$40.35
9/30/2026	$2,446.43	-$4,055.65	$43.48
Continuing Period			