

Company: GENTEX	Ticker: GNTX	Current Price: \$ 17.80	Sector: Consumer Discretionary	Industry: Auto Parts & Equipment
Target Price: \$21	TTM P/E: 15.60		Beta: 1.3	Market Cap: 5.1 billion
Stop Loss: \$14	P/B: 2.40		Credit Rating: B++ (ValueLine)	Avg Vol (3 months): 2.12 m
52 Week High / Low: \$12.93 / \$18.30				Dividend Yield: 2%

Company Background:

GENTEX was started in 1974 manufacturing fire protection product. The company was founded by its current CEO, Fred Baur by inventing the world's first dual sensor photoelectric smoke detector. However, currently the major product of GENTEX is auto dimming rear view and side view mirrors. The company has around 90% market share of auto dimming mirrors, which are mainly used in Automotive industry. Gentex has also recently launched auto dimming windshields for aerospace. The company manufactures all of its auto dimming mirrors in a highly automated factory in Michigan. Main customers of GENTEX are automobile OEMs and retail customers. Another major line of business is the SmartBeam technology, a camera based lighting system which optimizes the vehicles forward lighting environment. In September 2013, Gentex acquired HomeLink from Johnson's Control, thus diversifying further outside the mirror business. HomeLink is the world's most widely used vehicle-based wireless control system. Gentex is planning to launch an integrated toll paying capabilities into the rearview mirror this year. Within an eye on mirrorless market, Gentex also developed a Full Display Mirror pipeline, which integrates rear view mirror with the rear view camera. Gentex has more than 1,000 patents and is currently planning to expand its factory to cater the growing demand. The company has a consistent history of strong free cash flow and a low-debt balance sheet.

Industry Outlook:

Revenue from automotive accounts for 98% of Gentex's revenue. Auto dimmable mirror accounts for a large portion of the revenue from its automotive products. GENTEX has a market share of around 90% in auto dimmable mirror industry, making it almost monopolistic in the sub-industry. The Kids Transportation Safety Act of 2007 was signed into law in February 2008, which revises federal standards to expand the field of view so that drivers can detect objects directly behind vehicles. In December 2010, the U.S. Department of Transportation proposed rules regarding the required field of view to detect objects directly behind vehicles. The law might further expand the market of camera based rear view mirror giving a significant market share for Gentex's Full HD mirror. However, there is a risk of disintermediation of exterior mirrors as recent research has shown that exterior mirrors can decrease the fuel efficiency. Although the potential for auto part products in China is great, we avoided to include China in our analysis to have a conservative estimate.

Investment Thesis:

Light weight vehicle sales is expected to grow just on average 1-2% (in units) in the North America, Japan and Europe (where Gentex has significant exposure). However, global auto dimming mirror penetration is around 25%. Having a market share of around 90% in auto dimming mirror market, Gentex seems to have a lot of scope to penetrate further into the remaining 75% of the total light weight vehicle market. Thus, there seems to be no immediate threat from market saturation.

Magna, a \$ 32 billion company (in revenue) acquired Donnelly on 2002. Donnelly, which was also based in Michigan, was once an arch rival of Gentex following a number of patent suits. There were a lot of speculation, that the acquisition will pose significant threat to Gentex. However, market share of Gentex has in fact increased since 2002. Such a steady growth in the segment, could be attributed to Gentex's existing patents, operational efficiency, management focus on a narrow range of products among others. Thus, we wouldn't expect a significant threat from competition in near term.

Gentex's revenue from its top three clients (Volkswagen, Ford and Toyota) accounts for 36% of its total revenue. That is indeed a risky exposure. However, its dependency on top three clients appears to be decreasing as Gentex is diversifying its business into aerospace (auto dimming aircraft windshield) and other automotive products. Insider trading by Fred Baur appears to be another concern. However, Fred Baur (Founder and CEO) has a historical record of trading Gentex stock. Fred, who turned 73 is not a board member of any other company and has devoted almost half of his life on Gentex. We do not see any wrong intention in his insider trading. Gentex's consistent net margin of 15-20% during normal years and a healthy 9% margin during recessionary years shows its business moat in the past. It should be largely due to patent protection (with over 1000 patents) and operational excellence (highly automated, 100% manufactured in US).

That said, we do not see a long term economic moat for this business due to patent expiration schedules. Even the best electronic company may not be able to keep abreast with the changing technological needs. However, for the short term (5-7 years) we believe Gentex would maintain its historical profit margin.

An investor overreaction in case of a less favorable results in the next five years is possible. The company has kept a high expectation through its past performance, and any slight negative turn might cause overreaction by the investors. Current earnings yield is around 6%. Conservatively, a 5% of growth on diluted EPS could be expected over the next 5 years. If the earnings yield goes as high as 11% (PE 9) and EPS growth rate is 4%, price will be around \$12/share in 2021. That is a downside risk of 33%. A fair expectation of 10% EPS growth and an earnings yield of 6.67% (PE 15), will bring the price to \$ 26/share, an 8% compounded return by 2021.

Financial Performance

	2011	2012	2013	2014	2015	LTM 6/30/16
Revenue (\$mil)	1024	1100	1172	1376	1544	1625
Gross Profit (\$mil)	362	373	431	539	604	641
Operating Profit (\$mil)	231	234	305	399	459	493
Net Income (\$mil)	165	169	223	289	318	333
Days Inventory (Days)	87.56	68.95	57.12	61.45	60.64	
EPS Growth YoY (%)	16.33	2.63	32.48	26.45	10.2	20
Operating Margin (%)	22.6	21.32	26	29	29.72	30.31
Net Income Margin (%)	16.08	15.33	19.02	20.98	20.63	20.53
Debt/Equity		0.2	0.16	0.13	0.12	
EPS (Diluted) (\$)	0.57	0.58	0.78	0.98	1.08	1.14
Number of Outstanding Shares (millions)	289	288	289	294	296	293
PE Ratio	26.40	16.10	24.60	18.20	15.80	15.60
Current Ratio	7.47	8.47	5.01	6.42	7.51	
ROE (%)	17.15	15.7	18.21	19.91	19.34	19.43
ROA (%)	15.12	13.81	14.72	15.24	15.27	15.44
Dividend Per share (\$)	0.24	0.26	0.28	0.31	0.34	0.34
FCF (\$mil)	21	140	262	255	254	294

Discounted Cash Flow

Avg	2011-2016	2016-2020
Revenue growth (5 yr)	14%	10%
EBITDA Margin (5 yr)	31%	25%
Net Income Margin (5yr)	18%	16%
Avg Debt/Equity 3 yr)	16%	15%
FCF Margin (5 yr)	18%	16%
FCF Growth	6.00%	6.00%
Tax Rate	32.20%	32%
Discount Rate		7.00%
WACC (using CAPM)	10.65%	
Perpetuity growth rate		3%

Analyst Opinion:

Buy:5	Hold: 4	Sell:1	Target
JP Morgan	Neutral		\$19
S&P Net Advantage	Buy 4/5		\$21
Value Line	Safety: 3		\$25-\$35

Relative Valuation

	Gentex	Magna Int	Industry Avg.*
P / E	15.6	8.5	13.17
P/B	2.4	1.80	2.82
Dividend Yield	2%	2.30%	0.90%
PEG (Reuters)	1.33	0.74	1.2 (BEst)
TTM EPS	\$1.14	\$5.23	3.56
Revn Growth (10 yr)	11.15%	3.49%	6.19%
Op Income Growth (5 yr)	19.31%	14.20%	12.66%
Operating Margin (%)	29.72	7.24	11.20%
Debt / Equity	12%	26%	34%
Market Cap	\$5.1 B	\$16.55 B	\$3.1 B
Revenue TTM	\$1,625 M	\$34572 M	\$4.61B
FCF (5 yr avg)	\$186.4 M	\$850.2 M	

Total Return

	Gentex	Auto Parts*	S&P 500
1 Year	11%	12%	8%
Last 3 Year	13%	6%	13%
Last 5 Year	8%	15%	10%

ESG (Bloomberg)	Gentex	Industry
ESG Disclosure Score	34.71	15.18
Governance Disclosure Score	51.79	49.51
Social Disclosure Score	24.56	16.67
Environmental Disclosure Score	31.75	15.18

Prepared by Azmath Rahiman (Oct 10, 2016) using Bloomberg, Value Line, S&P Net Advantage, Capital IQ, Reuters, Morning Star Direct, Yahoo Finance and other resources from GENTEX and Morgan Stanley

*BICS Best Fit Auto Parts US