

September 14, 2017  
Company Update

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### Ctrip (CTRP US)

|            |              |
|------------|--------------|
| Price      | USD 18.93    |
| Market Cap | USD 5.41 bln |
| TTM P/E    | 17x          |
| S/I        | 7.72%        |

Gentex (GNTX US) last share price in USD (left, blue) and volume in mln shares (right, pink)



Source: Bloomberg September 13, 2017

## Gentex (GNTX US)

# Continuing Market Irrationality

- ▶ **Importer:** Contrary to its public statements, Gentex is importing some finished dimming mirrors from a German manufacturer in Shanghai and valuable components from other third parties.
- ▶ **Crazy capex:** What could Gentex possibly spend USD 100-115 mln on this year? Magna is building the same facilities 5 miles away for USD 30 mln.
- ▶ **Why is the CFO position vacant?** Gentex has promoted Steve Downing. But in the meantime, there's no full-time CFO.

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**G**entex had an eventful summer. News has been unrelentingly grim and yet the stock has proven invulnerable. That is not, in our view, rational or sustainable.

## The Spruce Point report

On July 13, Spruce Point Capital Management [published a damning report](#) that proved Gentex has lied about critical portions of its business. Among the many, well-documented allegations:

- ▶ **Lowly assembler:** Instead of getting high margins through maniacal manufacturing controls and vertical integration, as the company has repeatedly claimed, Gentex buys 65% of the mirror components from third parties. Some of those third-party components are the most valuable ones.
- ▶ **Absurd overstatements of capex needs:** The company makes wild claims for needed investment--USD 465 mln in 2013, for example. It built a large lab facility and put just seven people in it. It is spending more than twice the level that competitor Magna spends for the same production facilities. And there are dark pockets in the capital budget. In 2016, Gentex reported spending nearly USD 21 mln on “corporate capex” but did not explain how the already lavish campus in Zeeland, Michigan could possibly absorb that new spending. Pure-gold bathroom fixtures?
- ▶ **Cited for lack of documentation:** The Michigan Department of Environmental Quality issued a violation notice to Gentex because the company could not document its capital expenditures. Interviews with former Gentex executives make it plain that the company is not documenting that heavy capex spend.

Instead of responding to the Spruce Point report, Gentex ignored it on the quarter call.

## Other bad news

The Q2 report was ugly but there was little effect on the stock.

- ▶ Gentex reported a missed revenue target and a big drop in gross margin, from 39.4% a year ago to 37.7% in Q2 2017.
- ▶ News about auto sales has been consistently bad. Gentex said the second half will be better than the first but did not provide evidence.
- ▶ On August 22, the company announced that its CFO, Steve Downing, had been promoted, leaving the CFO position vacant. We note that Downing and

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Chief Accounting Officer Thomas Nash are the most lavishly compensated executives outside of the founder. Growing companies more often direct raises and bonuses to the technical and sales staff rather than to the people responsible for managing accounts.

And yet, after a dip following the results, the stock has just kept on climbing.

We think this is a dead-obvious story of a company that is overstating its margins by around 50%, taking the phantom profits generated through the overstatement and putting them into overstated capex. This is a classic “propping and tunneling” strategy familiar to us from Chinese companies. Use faked profit to prop up the stock, tunnel the fake cash off the books through inflated capex spending, and cash in on the elevated share price. Indeed, company founder Fred Bauer has made tens of millions by selling his stock at less-than-market price.

**Confirmation of the short thesis**

We recently accessed import data for Gentex from Import Genius. The data provide more support for our view that Gentex cannot be getting 39% gross margins from assembling 30 million side and rear-view mirrors every year.

**Importing from Flabeg**

Gentex is importing finished mirrors from [Flabeg Automotive Mirrors](#), a German company that manufactures automotive dimming mirrors in Shanghai, according to U.S. Customs records obtained from Import Genius. We confirmed in a telephone call to company sales staff that Gentex is a client for finished mirrors. Records do not provide the value of shipments but only the kilos shipped:

**Interior Mirrors Imported by Gentex**

| Year | kilos shipped |
|------|---------------|
| 2014 | 28,531        |
| 2015 | 34,130        |
| 2016 | 55,130        |
| 2017 | 14,270        |

Source: US Customs, Import Genius

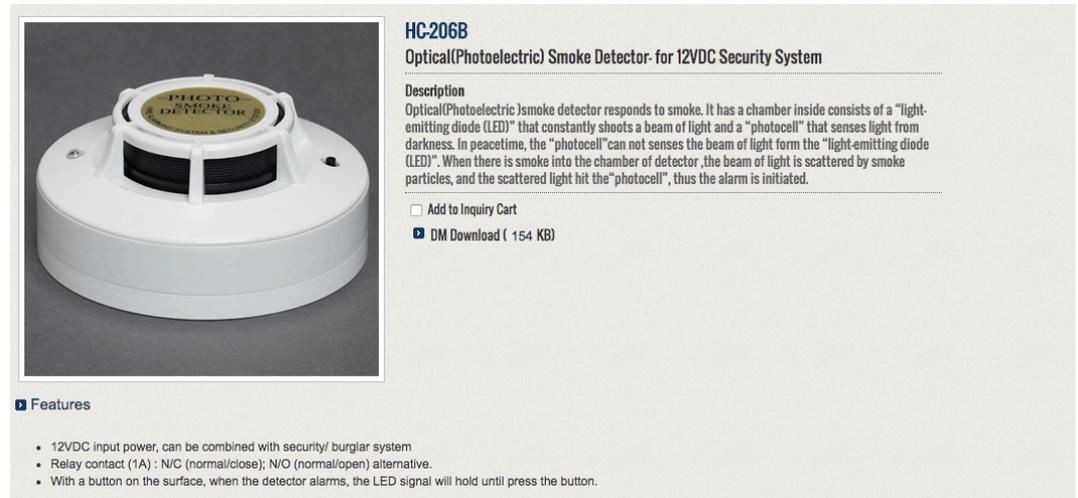
Gentex shipped 28.9 mln mirrors in 2014, 33 mln in 2015, and 36 mln in 2016. A Gentex automotive rear-view dimming mirror weighs 1.1 pounds, so the 2016 shipment represent roughly 110,000 mirrors—a very small portion of Gentex’s total. Flabeg, the records show, is a major supplier of glare-reduction mirrors and glass to Gentex customers Honda, Ficoso, and Velvac, among others. But Gentex has never mentioned this company as a competitor.

Customs records also show imports of what appear to be rear-view cameras, electrical components from a German company called [FEP](#), Eagle Glass from China and float glass from Taiwan, lenses, loudspeakers, inductors, printed circuit boards (bare), transformers, housings, and so on. All of this is unremarkable for an assembler, as we maintain Gentex is. The only thing we have evidence that Gentex actually does is print circuits on PCBs and assemble glass, PCBs, and plastic housings. Nothing wrong with that, but it is not what Gentex claims and it emphatically does not support the company’s margin claims.

The imports also bring into question why the company needs to be spending so much on capital plant. In 2017, Gentex projects between USD 115-130 mln in capital expenditures. Executives cannot explain what that might be for. By contrast, the world’s leading mirror manufacturer, Magna Mirrors, is tripling its electrochromic mirror capacity in Holland, Michigan, just down the road from Gentex, for USD 30 mln. (See the company press release [here](#).) It should be noted that Magna has exactly the same auto-dimming technology as Gentex. It seems that Magna, which has long downplayed the auto-dimming mirror, may have started to believe the Gentex reports about its superior margins.

**Fire protection—also not so original**

One oddity that emerges from the import records is the quantity of complete fire alarms that Gentex is importing. A major supplier is the [Hong Chang](#) Fire Brigade Materials company in Taiwan. Hong Chang’s specialty is a photoelectric smoke detector, the type on which Gentex was founded in 1974. The company says that its founder, Fred Bauer, invented the photoelectric alarm, which “sees” smoke optically and reacts quickly. The story has a special place in the hearts of Americans who love Django Reinhardt, the jazz guitarist who lost two fingers in a conflagration in his trailer home when cellophane flowers caught fire. He would have benefited from



**HC-206B**  
Optical(Photoelectric) Smoke Detector- for 12VDC Security System

**Description**  
Optical(Photoelectric) smoke detector responds to smoke. It has a chamber inside consists of a "light-emitting diode (LED)" that constantly shoots a beam of light and a "photocell" that senses light from darkness. In peacetime, the "photocell" can not senses the beam of light from the "light-emitting diode (LED)". When there is smoke into the chamber of detector, the beam of light is scattered by smoke particles, and the scattered light hit the "photocell", thus the alarm is initiated.

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**Features**

- 12VDC input power, can be combined with security/ burglar system
- Relay contact (1A) : N/C (normal/close); N/O (normal/open) alternative.
- With a button on the surface, when the detector alarms, the LED signal will hold until press the button.

Screenshot from Hong Chang Fire Brigade Materials: <http://www.hong-chang.com.tw/s/2/product.html>

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an optical alarm. At any rate, it seems that Hong Chang is now making the alarms more economically than their “inventor,” Gentex.

The alarm and smoke detector business is not critical to Gentex’s growth, although the company reported 15% growth in 2016. Gentex’s “Other” category includes fire protection products and dimmable windows for aircraft and showed revenues of USD 39.2 mln in 2016. That year, Gentex imported 7,608 kilos of fire alarms from the Hong Chang and 23,273 kilos of alarm parts from various manufacturers in Shanghai.



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One of the high-end optical alarms selling on Taobao for under USD 15. Screenshot: <https://item.taobao.com/item.htm?spm=a230r.1.14.61.76bf523Ai9HH4&id=45461920060&ns=1&abucket=20#detail>

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