

February 16, 2017  
Coverage Update

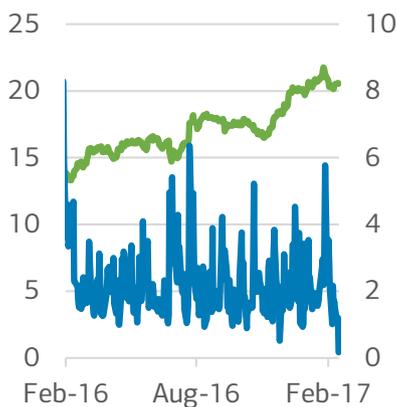
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## Gentex (GNTX US)

Price	USD 20.59
<b>Target Price</b>	<b>USD 8.70</b>
<b>Difference</b>	<b>58%</b>
Market cap	USD 5.88 bln
TTM P/E	17x
Gross yield	1.75%
5-yr net growth	8.14%
S/I	7.72%

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



Source: Bloomberg, February 15, 2017

## Gentex (GNTX US) Just More Hype

### ► More for less

Gentex announced a 23% increase in capital spending in 2016 and said capex would remain elevated in 2017. Its new “camera monitoring system,” or CMS, is being promoted as a mirror-based alternative to the LCD backing camera. But the hype seems to exceed the future value of CMS.

### ► HomeLink for China

For 2017, Gentex guided to revenue growth between 6-10% and margin expansion. The company looks like it will be seeking profit from the China market—a non-starter in our view.

### ► Lowering price target

Gentex’s increase in capex for 2016 to USD 121 mln negatively impacts free cash flow to equity and pushes down our target price from USD 9 to USD 8.70. That target price is based on the assumption that Gentex’s gross margin is actually 20% and not the reported ~40%.

### ► Slow burn

We expect slow erosion in the share price over the next 24 months, as Gentex sinks cash into new technologies but fails to deliver.

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## Low-End by Any Other Name

When Juliet ruminates that “a rose by any other name would smell as sweet,” she is trying to say that Romeo would be the same person whether he’s called Montague or Capulet. Well, that goes for the Gentex “premium” mirror offerings called “CMS,” “FDM,” and “RCD.” The Full Display Mirror (FDM), which includes a backing display, is supposed to be the high-margin answer to LCD-based backing cameras. Gentex shipped fewer than 200 of them in 2015 and has not announced how many were sold in 2016, though the mirrors are in some Cadillac models and, as of Q4 2016, in the Chevy Bolt. The FDM is just the newer iteration of the Rear Camera Display (RCD) mirror that launched in 2006 but does not seem to have been installed in a lot of cars. As we have commented in the past, similar backing mirrors can be had for as little as USD 15 retail on Taobao.

Now it’s all about the CMS. That version of the camera-enabled mirror is five years off but may embed iris-scanning technology to start the car and monitor driver fatigue. The iris-scanning technology is to come from a company called Delta ID, in which Gentex has taken a minority position for an undisclosed amount of money. On February 2, Fingerprints (FING-B STO) acquired Delta ID for USD 106 mln, so that stake may have become more valuable.

The Delta ID technology is intended to create “an embedded biometric solution for vehicles.” In the Q4 call, Gentex management said, somewhat inscrutably:

“There are many use cases for authentication in the car which range from vehicle security to start functionality, the personalization of mirrors, music, sea location, temperature, to the ability to control transactions not only for our Integrated Tool Module system but also for the ride sharing car of the future.”

Seeking Alpha GNTX Q4 management call transcript

Sea location? Anyway, notice the diversion to the “Integrated Tool Module.” Gentex would have us believe that its mirrors will be the cockpit of automation for the vehicles of the future. That promise has been made before. We are focused on how little is currently on offer for that fat reported margin.

Whether or not technologies can plausibly be added to the mirrors, Gentex has no particular technological edge. The image-processing chips for Gentex's backing cameras come from Ambarella (AMBA US). Gentex was also licensing Mobileye (MBLY) technology for the cameras but ended that cooperation, saying it was too expensive. Even Ambarella, a fabless chip designer that owns considerable technology, gets lower gross margins than Gentex does—35%—and Gentex, which is merely assembling parts, manages to exceed 39%. In fact, the camera display mirrors would have to exceed 60%: products like the plain auto-dimming rear view mirror, management has said, get margins in the low twenties, so a high-value component like rear display would need to be pulling down something like 50% over the average in order to drag up totals.

## Capex grows, but for what?

In keeping with the effort to develop more high-value stuff, management said in the Q4 call that capital expenditures would continue to grow in the double digits for the next couple of years. The company announced that 2016 capex came in at USD 122 mln, for a 23% increase over 2015. Management also said that R&D costs would rise.

## Industry-beating shipments

Gentex reported Q4 results on January 27. Gross margin improved but revenue missed slightly. SG&A was up due to costs for express deliver-

**Table 1. Gentex Capacity and Shipments (mlns of units)**

	2016	2015	2014	2013	2012	2011	2010
<b>Capacity</b>							
Interior			25.5	22.0	22.0	22.0	20.5
Exterior			11.0	10.0	10.0	10.0	9.0
<b>Total</b>		49.0	36.5	32.0	32.0	32.0	29.5
<b>Shipped</b>							
Interior		23.5	21.1	19.4	18.1	16.2	12.8
Exterior		9.5	7.8	6.9	5.8	5.3	4.3
<b>Total</b>	36.0	33.0	28.9	26.3	23.8	21.5	17.1
<b>Utilization (%)</b>							
Interior			82.7%	88.2%	82.2%	73.6%	62.6%
Exterior			70.9%	69.0%	57.5%	52.9%	47.4%
<b>Total</b>		67.3%	79.2%	82.2%	74.5%	67.1%	57.9%

Source: Company data (midpoint management estimates) and J Capital

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ing products to OEMs because of shortages of plastic used in the mirror assemblies, the company said. That those express delivery costs were put into SG&A preserved that industry-beating gross margin.

As usual, Gentex outperformed the industry in the quarter and the year. Unit sales rose 9% for the year compared with 3% light vehicle unit sales growth in Gentex’s markets, according to the latest Scotiabank report on auto sales. Gentex achieved this despite continuing OEM pressure to reduce prices by 2.5-3%—the company said that a higher proportion of premium features in the mirrors boosted price.

**Table 2. International Car Sales by Region (mlns of units)**

	North America	Western Europe	Eastern Europe	Asia	South America	World excl. S. America	YoY
<b>1990–1999</b>	16.36	13.11	1.18	6.91	1.64	37.56	
<b>2000–2011</b>	17.97	14.26	2.75	13.05	2.68	48.03	28%
<b>2012</b>	17.11	11.76	4.14	27.25	4.72	60.26	25%
<b>2013</b>	18.33	11.55	4.08	29.98	4.75	63.94	6%
<b>2014</b>	19.38	12	3.8	31.69	4.15	66.87	5%
<b>2015</b>	20.64	13.2	2.91	32.29	3.33	69.04	3%
<b>2016*</b>	21.13	13.73	2.8	33.6	3.13	71.26	3%

Source: Scotiabank, 2016 figures projected

In 2016, two OEMs were expected to launch HomeLink in China. Management has commented that they expect good sales growth in China, where sales of passenger cars rose by nearly 14% in 2016. But China has virtually no private garages. Gentex management says that the China version of HomeLink will open the gates at the private compounds in which many middle class Chinese live. This seems, to say the least, unlikely.

## Valuation

We remain unconvinced. Despite the buzz about CES show launches and biometrics, Gentex is fundamentally selling a piece of reflective glass in a plastic casing. While the company has intellectual property in HomeLink, it really has no other technological content with significant value. And HomeLink sooner or later will see its market eroded by lightweight cell phone applications. We simply do not believe Gentex’s reported margin profile. We value the company at USD 8.70.

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## Risks

Gentex claims to be working on software for image-stitching as well as other technologies relevant to backing images. The company says that LCD backing cameras are no threat, since Gentex mirrors already offer that capability. If those assertions turn out to be true, Gentex could be well positioned for growth.

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