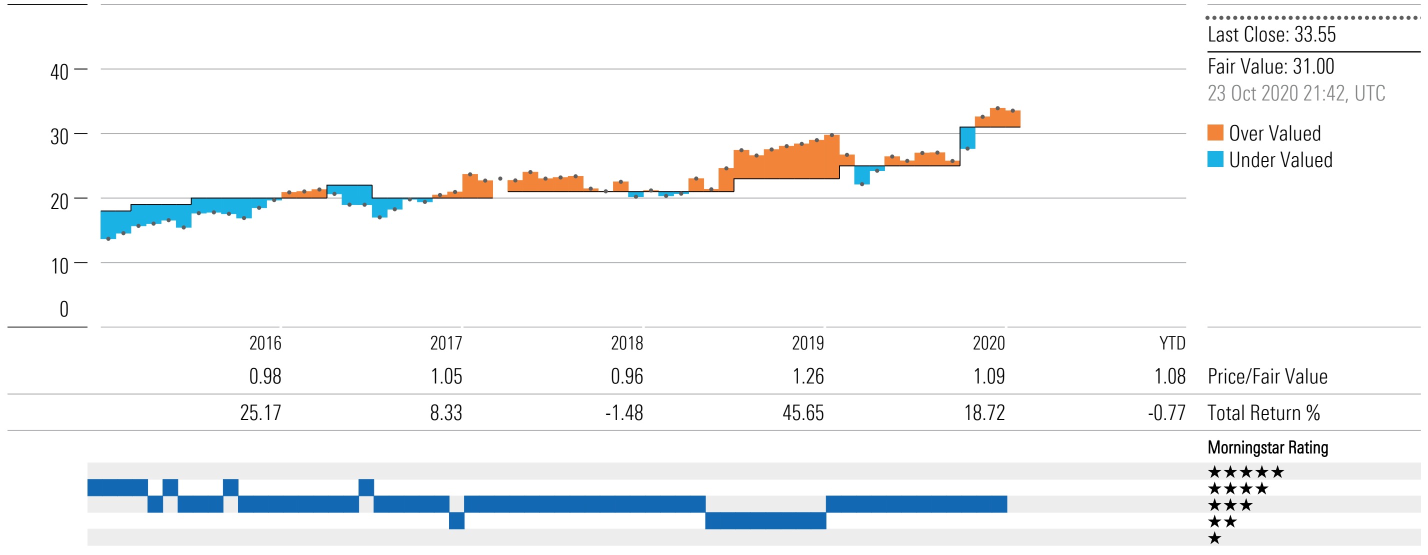
Gentex Corp GNTX ★★★ 28 Jan 2021 22:17, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Moat Trend™	Uncertainty	Capital Allocation
33.55 USD 28 Jan 2021	31.00 USD 23 Oct 2020 21:42, UTC	1.08	8.22 USD Bil 28 Jan 2021	Narrow	Stable	High	Standard

Price vs. Fair Value



	2016	2017	2018	2019	2020	YTD
Price/Fair Value	0.98	1.05	0.96	1.26	1.09	1.08
Total Return %	25.17	8.33	-1.48	45.65	18.72	-0.77

Total Return % as of 28 Jan 2021. Last Close as of 28 Jan 2021. Fair Value as of 23 Oct 2020 21:42, UTC.

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The primary analyst covering this company does not own its stock.

Gentex Ends 2020 With Record Quarter

Analyst Note David Whiston, CFA, CPA, CFE, Sector Strategist, 29 Jan 2021

Gentex reported an excellent fourth quarter to end 2020 with diluted EPS up 48.7% year over year to $0.58, besting the Refinitiv consensus of $0.50 and setting an all-time Gentex record. Roughly low- to mid-teens unit percentage growth in all mirror segments (versus only a 3% rise in global light vehicle production), and robust demand for advanced feature products such as the full-display mirror, enabled Gentex's revenue to rise 19.4% to a quarterly record $529.9 million, well above Refinitiv consensus of $482.97 million. This mix shift, favorable operating leverage, and Gentex achieving purchasing cost reductions upstream enabled an impressive 440-basis-point gross margin improvement to 40.9%, the best level since second-quarter 2004. We are not changing our fair value estimate, but we will reassess all valuation inputs after the 10-K is filed.

We continue to see Gentex in a dominant position for supplying autodimming mirrors and see upside to its new product offerings such as the integrated toll module, airplane windows, and in the long-term healthcare applications such as lighting for operating rooms and iris identification and smoking detection for the interior of autonomous vehicle fleets. The company's fortress balance sheet is now once again debt free, and its cash hoard of $612.6 million suggests Gentex will have no problem investing for future innovation while also funding present operations. Management also continues to repurchase Gentex stock, with 4% of shares bought back in full-year 2020 via $288.5 million in spending at an average price of $27.10 notably below current levels, so the money was not wasted in our view.

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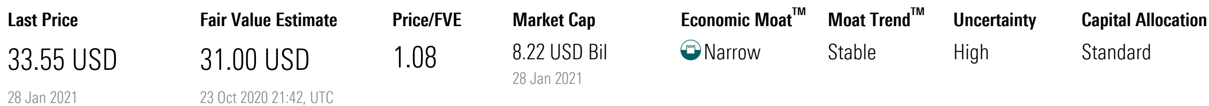

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Sector	Industry
Consumer Cyclical	Auto Parts

Business Description

Gentex was founded in 1974 to produce smoke-detection equipment. The company sold its first glare-control interior mirror in 1982 and its first model using electrochromic technology in 1987. Automotive revenue is about 97% of total revenue, and the company is constantly developing new applications for the technology to remain on top. Sales from 2019 totaled about $1.9 billion with 42.9 million mirrors shipped. The company is based in Zeeland, Michigan.

Authorization for 9.4 million shares remains, and we'd expect the board to approve more buybacks when necessary.

Business Strategy & Outlook David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

Gentex manufactures auto-dimming rear- and side-view mirrors that use electrochromic technology. These mirrors automatically darken to eliminate headlight glare for drivers and have many other applications. With over 1,500 patents worldwide, some valid through 2044, and a dominant 94% market share, up from 77% in 2003, Gentex has a narrow economic moat it should be able to protect for a long time despite the economic damage from COVID-19.

The growth prospects for auto-dimming mirrors look strong. Gentex estimates that in 2018, about 31% of all cars had interior auto-dimming mirrors, and about 13% had at least one exterior auto-dimming mirror. Demand remains healthy with annual revenue growth often exceeding industry vehicle production growth. Growth will come from increased vehicle penetration as more original-equipment manufacturers make the safety benefit of auto-dimming technology available and as Gentex's research leads to new, advanced-feature mirrors that ultimately become standard products.

SmartBeam, which automatically turns a vehicle's brights on or off and can also allow brights to be on continuously, is sold mostly in Europe, but its safety benefits could expand if U.S. regulators change current rules as proposed in October 2018. Research has found that drivers use their brights optimally only about 25% of the time. Active safety is a very fast-growing field, so more camera products are likely to show up on other vehicle programs and Gentex develops its own cameras. A recent example is the full display mirror, which the driver can toggle between a normal auto-dimming mirror and a display image while driving at high speed. Other growth areas include biometrics in mirrors, which we see having application in autonomous ride hailing, dimmable sunroofs, and universal toll payments.

The future beyond autos looks bright to us, too. The company supplies auto-dimming passenger windows for the Boeing 787, and has agreements to supply the 777X, and unspecified Airbus planes. Gentex is also targeting RFID parking barriers in Asia with HomeLink and exploring healthcare smart lighting applications with the Mayo Clinic.

Bulls Say David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

- Auto-dimming technology has applications to other parts of the car like headlights, as well as outside autos such as airplane windows. Although small now, markets outside the auto industry could prove to be very large businesses down the road.
- The company's financial health is so strong that we think Gentex can survive any downturn in the U.S. easier than other auto suppliers can.

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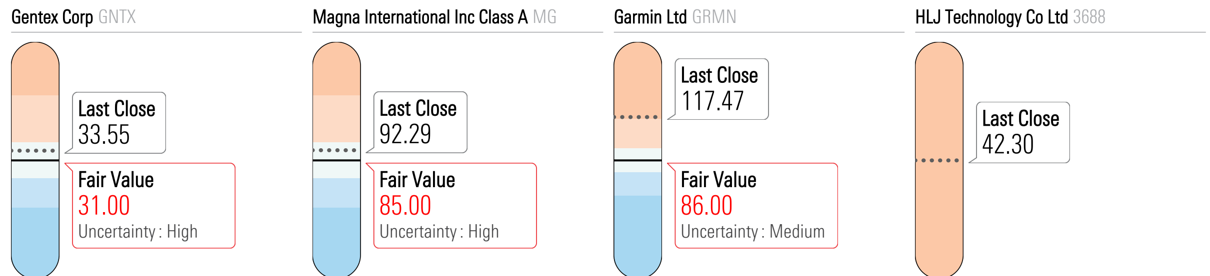
Competitors



	Gentex Corp GNTX	Magna International Inc Class A MG	Garmin Ltd GRMN	HLJ Technology Co Ltd 3688
Economic Moat	Narrow	None	Narrow	—
Moat Trend	Stable	Stable	Stable	—
Currency	USD	CAD	USD	—
Fair Value	31.00 23 Oct 2020 21:42, UTC	85.00 6 Nov 2020 19:32, UTC	86.00 28 Oct 2020 17:46, UTC	— —
1-Star Price	48.05	131.75	116.10	—
5-Star Price	18.60	51.00	60.20	—
Assessment	Fairly Valued 28 Jan 2021	Fairly Valued 28 Jan 2021	Significantly Over Valued 28 Jan 2021	— —
Morningstar Rating	★★★28 Jan 2021 22:17, UTC	★★★28 Jan 2021 22:49, UTC	★28 Jan 2021 22:17, UTC	—
Analyst	David Whiston, Sector Strategist	Richard Hilgert, Senior Equity Analyst	Julie Bhusal Sharma, Equity Analyst	—
Capital Allocation	Standard	Standard	Standard	—
Price/Fair Value	1.08	1.09	1.37	—
Price/Sales	5.15	0.70	5.72	5.48
Price/Book	4.34	2.13	4.40	1.64
Price/Earning	27.50	48.47	22.04	31.57
Dividend Yield	1.43%	2.34%	2.04%	4.23%
Market Cap	8.22 Bil	27.62 Bil	22.46 Bil	3.97 Bil
52-Week Range	19.48—37.75	33.22—97.98	61.04—125.00	33.40—89.29
Investment Style	Mid Core	Large Value	Large Growth	Small Growth

- Biometrics, surgical room utlraviolet lighting, and electronic toll payments could open up new revenue streams for the company.

Bears Say David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

- Cameras could replace Gentex's mirrors, if regulators throughout the world allowed it. We don't think this is a likely threat, at least not anytime in the near future in very large volume.
- Gentex hoards cash but has made good effort to buy back stock while increasing its dividend. A higher dividend would give shareholders--instead of management--more control in allocating excess capital.
- As auto-dimming mirrors become available on more vehicle models, OEMs may want to lower their own costs by pressuring Gentex to reduce prices, or by supporting emerging competitors.

Economic Moat David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

Gentex's cost advantage from economies of scale, its customers' switching costs, and intangible assets give the firm a narrow moat. Patents, innovations such as SmartBeam, and a consistent world-class

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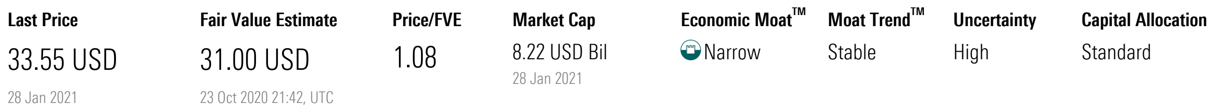

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manufacturing process have let the firm increase its auto-dimming mirror share to 94%. We see this as representative of a moat because Gentex does not give any reason for a customer to try another auto-dimming mirror supplier nor leave room for many competitors. The firm's technological leadership increases our confidence that Gentex will hold, if not keep increasing, market share. Given that the company is patient with its engineers in order to encourage innovation, we do not think Gentex will lose its competitive edge. Its research and development spending as a percentage of revenue is one of the highest in our supplier coverage. Gentex was the first to market with electrochromic automatic-dimming mirrors, so the company enjoyed pricing benefits from the early adopters of the technology. Its unique product and its ability to commercialize the technology and continually make patent-protected innovative changes to the automatic-dimming mirror has enabled Gentex to generate returns on invested capital vastly superior to other auto suppliers. The company's market share gain to 94% of auto-dimming mirrors from the low 80s in recent years shows the superior quality of its product and the reliability of Gentex to deliver on time, suggesting that customers would face switching costs to move over to Magna Mirrors.

Auto suppliers are not chosen purely on price. A firm has to be reliable and get it right every time while also serving an automaker globally. There are not many suppliers that can do that, let alone mirror suppliers that can. Once a supplier has the business, it is extremely rare to lose it, especially during a vehicle program, because automakers then have to remove tooling from the supplier, which can cost millions. An automaker would also have to incur expensive validation testing of a new supplier, all while the production line is not making any vehicles and decimating an automaker's ability to recoup its fixed costs. Gentex also has traditionally kept a debt free balance sheet, partly so its cash hoard ensures it can keep its supply chain moving (such as in the Great Recession or after the Japan tsunami) and thus will never be the reason an automaker has to stop its production line.

This consistent reliability is not something that just anyone who can get a loan to start a mirror company could do easily or quickly. Automakers' move to more global platforms is very good news for Gentex since a supplier must be able to service the OEM consistently all over the world. A regional player cannot do this, and we think a small firm would be hesitant to borrow lots of money to add new facilities and overhead all over the world without any guarantee of winning new business. Automakers want the same supplier on a program all over the world due to scale benefits for them and reliability with a vendor that knows the vehicle program.

Gentex grows its share and keeps competitors at bay by bringing many, often patented, offerings (SmartBeam, HomeLink, FDM, telematics, and so on) into the electrochromic mirror, which, along with Gentex's consistent quality (both in the mirror and in the ease of integration of the mirror into the vehicle's other systems), makes it hard to beat in a proposal. These add-on features make the automaker

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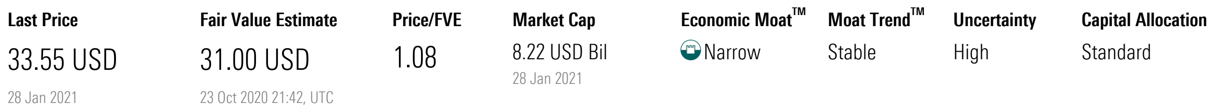

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money too because they are typically bundled with other non-Gentex features in an expensive tech or safety package on a vehicle. This allows the automaker to offer a variety of trims without having to redesign a vehicle's interior at great expense. Gentex has also told us the customer (the automaker) makes more money on Gentex products than Gentex does, which helps the switching cost moat source because a customer has little reason to switch on something it is buying for say $45 and selling as one part of a multi-thousand dollar option package. Also, with growth potential in vision systems (FDM, camera monitoring systems), the connected car via HomeLink and the integrated tolling module service, and large area dimmable surfaces (sunroofs, airplane windows), we don't think AVs automatically mean doom for Gentex.

However, the company is probably not a wide-moat candidate, in our opinion. Even Gentex faces customer demands for annual price reductions of about 2%-3%. Gentex's gross margins declined to 32.6% in the recession years of 2008 and 2009, from 43.2% in 1999. Suppliers are at the mercy of the automakers' production schedules and relentless annual demands for price concessions. Each automaker's volume makes the supplier very dependent on this large source of revenue. Furthermore, the auto industry is so cyclical that in bad times even the best parts suppliers cannot avoid large declines in return on invested capital and profit. In Gentex's case, ROIC was more than 40% in the late 1990s but fell to about 15% in 2009, before rebounding to about 25% in subsequent years. Cost-cutting helps ease the pain, but it does not restore all lost profit. We model ROIC in the mid- to upper 20s and low-30s for most of our five-year forecast period.

Fair Value and Profit Drivers David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

In light of 2020 trending better than modeled as a recovery from the pandemic is happening faster than expected, Gentex introducing 2021 revenue guidance of 15%-20% growth from 2020, cost reductions from second quarter we think enabling the chance of gross margins next year of nearly 40%, and time value of money, we are increasing our fair value estimate to $31 from $25. We model revenue to increase about 6.6% on a five-year compound annual basis, up from 3.7% in our prior model, with about a 12% decline in 2020 due to COVID-19 and then high-single-digits to mid-teens growth in the outer years of our forecast period. We model operating margin to average about 26% during our five-year explicit forecast period, up from about 24%. We project revenue based on a global vehicle production forecast, global auto-dimming mirror penetration, Gentex's market share, and average selling price. We assume a continued increase in penetration for some of our forecast period due to attractive growth prospects and Gentex's history. We believe additional margin expansion will remain difficult but not impossible, since automakers always seek price concessions.

The full display mirror, which the company refers to as FDM, is an innovation we like. We have driven several vehicles with this mirror and think that the full display mirror is far safer than a conventional auto-dimming mirror. Although major revenue from this mirror is not expected for a few more years, we

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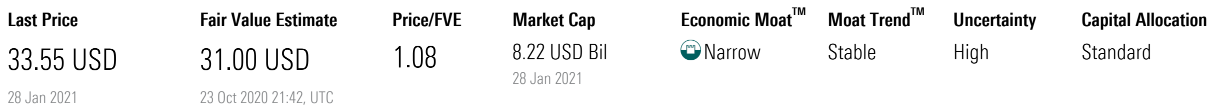

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think it has potential to be in every vehicle in the developed world due to its superior function over a normal mirror. Gentex has FDM contracts with eight automakers as of fall 2020, including GM and Toyota. We think the firm's manufacturing efficiency, product expertise, and high-tech products will keep gross margins in the upper 30% range but continued research and development, annual price reductions, and overhead spending will prevent major operating margin expansion. We project capital expenditures in the upper 5% of revenue range for most of our forecast period and R&D expenses of about 7% of revenue on average. Our long term tax rate is 19% and our weighted average cost of capital is 9%.

We model Gentex's auto-dimming mirror market share going to 95% over our five-year explicit forecast period because we see no major threat from other firms. Gentex’s quality and reliability are very hard to beat, and customers do not source mirrors solely based on price, which reduces the threat from low-cost Asian suppliers.

Risk and Uncertainty David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

Gentex's only large competitor is Magna Mirrors. Magna has much deeper pockets than Gentex and could invest substantially in its auto-dimming mirror group to try to beat Gentex's technology advantage or devote more sales resources than Gentex can afford. Also, there is always the possibility that a new and superior technology will be invented and take over the auto-dimming mirror market, but we consider this risk remote. The HomeLink acquisition could prove to not be as lucrative as management expected. Some products such as high-beam assist are increasingly going into bundled packages in higher-trim vehicles, which means more competition for Gentex’s SmartBeam product. Finally, it is possible that Gentex could be put out of the automotive supply chain if governments start allowing camera technology to replace all types of mirrors in a vehicle, as Europe and Japan now do under UN-ECE Regulation 46. Although we think cameras replacing mirrors in large volume is more than a decade a way if it even happens at all, our fair value estimate may be severely reduced if such legislation causes consumers to prefer cameras over mirrors in large volume or fully autonomous cars lead to no mirrors in a vehicle. The company’s expertise in camera systems, however, may make this legislative risk far less problematic than Gentex’s critics fear. Furthermore, currently display-only systems require retooling of the vehicle and cost more than a mirror. Uncertainty as to image quality in poor weather or from other obstructions needs to be considered by regulators as well. A dual camera/mirror system provides a redundancy for safety in case a camera’s lens is blocked by weather or debris on the lens. In light of this regulatory risk, the fact that Gentex's stock price is not immune to the cycle whims of the auto industry, and more active safety content possibly being placed in the center stack, dashboard, or window, rather than the mirror, our fair value uncertainty rating is set at high.

Capital Allocation David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

Former chairman and CEO Fred Bauer founded Gentex in 1974 and owned 2.3% of the company until his

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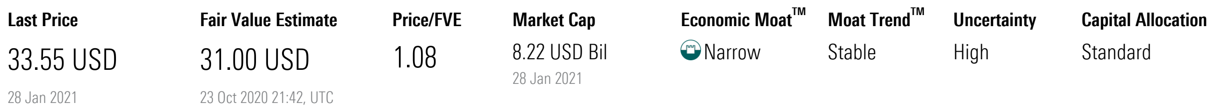

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retirement in January 2018. Bauer retired from the board as well but remains an employee for advisory services for five years after retiring. He will be paid $447,000 in 2020, and $298,000 in 2021 and 2022. Bauer also received a $2.1 million retirement payout, and Gentex bought a building it uses owned by Bauer for $950,000. Gentex also repurchased about 5.5 million Gentex shares owned by Bauer for $20.98 a share, about 2.3% of the company and effectively all of Bauer's stock. This retirement package is more generous than we'd like to see but not surprising, given that Bauer is the founder.

Lead independent director James Wallace is now chairman, while President Steve Downing, 42, added the CEO role in January 2018. Downing joined Gentex in 2002, and we think he is an outstanding executive and the right choice for CEO because of his strong knowledge of Gentex's finances as well as its products and operations. Downing was CFO and treasurer until his promotion to president, COO, and treasurer in August 2017. Downing does not have an employment agreement, but that may change now that he is CEO, though Gentex typically does not have contracts with its executives. Kevin Nash, 45, joined Gentex in 1999 and worked his way up to the CFO role in February 2018. He is also treasurer. Five of the board's nine members joined since 2014 and two members joined in 2018. CEO Downing joined the board in 2020 for the first time.

Management has achieved returns on invested capital far exceeding the cost of capital for many years, which we expect to continue. The company generates so much free cash flow (typically about 15% to 25% of sales) that until the HomeLink acquisition in September 2013, it had amassed cash and an investment portfolio, mostly consisting of stocks and government bonds, amounting to more than half of assets. Rather than piling up investments, we prefer to see an even higher dividend or more share repurchases when the stock is trading well below our fair value estimate. At a minimum, we'd like to see management repurchase shares to offset dilution from stock-based compensation.

A share repurchase in the third quarter of 2012 was the company's first since the fourth quarter of 2008. No shares were repurchased in 2013, but management spent $30 million on buybacks in 2014, $111.3 million in 2015, $163.4 million in 2016, $231.4 million in 2017, $591.8 million in 2018 including buyback of Bauer's shares, and $331.5 million in 2019. The diluted share count at year-end 2019 is down by nearly 15% since the end of 2015. Management bought back shares in 2019 at an average price per share of $24.06 and cumulative buybacks for 2003-19 at $1.87 billion were at an average of $14.76 by our calculation. Management's comments to us indicate it is willing to repurchase stock even in the midst of a recession, which we agree with but it's rare as most firms prefer to hoard cash in the depths of a crisis. During the coronavirus pandemic, Gentex did not buy back stock in second quarter 2020 but did in the third quarter, so we think management's actions match its words on buybacks.

We think management recognizes when its shares are cheap enough to buy back but, in the past under

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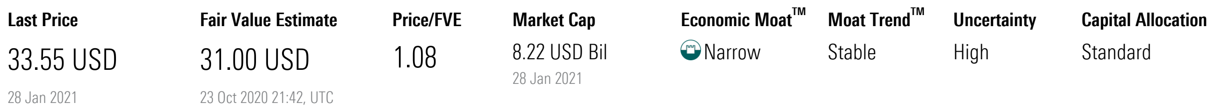

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Moat Trend™	Uncertainty	Capital Allocation
33.55 USD 28 Jan 2021	31.00 USD 23 Oct 2020 21:42, UTC	1.08	8.22 USD Bil 28 Jan 2021	Narrow	Stable	High	Standard

prior leadership, we wished it would have acted on that knowledge sooner. The leadership team put in place several years ago is far more willing to buy back shares than we've seen under the prior regime; we just want Gentex to do it only when the stock is trading well below our fair value estimate. We think Bauer's capital-allocation preference was share repurchases because of his dislike of the double taxation of dividends. The company only started paying a dividend after tax cuts in 2003 under President George W. Bush. We don't expect a major change in capital allocation under Downing, but a small amount of debt being a permanent part of the capital structure could occur with Bauer retired. We are fine with Gentex remaining debt free however, as we feel a strong balance sheet is an underrated asset in the auto industry. In times of crisis, Gentex can keep receiving supplies because its vendors know Gentex will pay them, or buying back stock after a large sell-off. Plus this liqudity, in our view, means financial distress for Gentex is not something shareholders need to worry about.

Downing’s first stamp on capital allocation came with a March 2018 announcement of a 10% dividend increase and a lowering of the target for cash and investments to $525 million from $700 million. These moves suggest to us that dividends and buybacks will remain part of capital allocation on a regular basis. March 2018 and March 2019 both saw announcements increasing the repurchase authorization. The plan does not expire and has 11.9 million shares of authorization left at the end of September.

Analyst Notes Archive

We Believe Gentex's Third Quarter Shows the Chance for a Strong 2021 David Whiston, CFA, CPA, CFE, Sector Strategist, 23 Oct 2020

Gentex reported a 9.1% year-over-year increase in third quarter diluted EPS with the $0.48 posted beating Refinitiv’s consensus of $0.41. Revenue fell 0.7% but was the second-highest total ever recorded other than third-quarter 2019, so the good quarter faced a tough comparable. In light of 2020 trending better than modeled as a recovery from the pandemic is happening faster than expected in the spring, Gentex introducing 2021 revenue guidance of 15%-20% growth from 2020, cost reductions from second quarter in our view enabling the chance of gross margins next year of nearly 40%, and the time value of money, we are increasing our fair value estimate to $31 from $25.

We expect for at least through 2021, provided there is not another pandemic-induced shutdown, that the $35 million in savings realized from salaried headcount reductions in second quarter, combined with continued volume recovery from the coronavirus, should enable strong quarters for Gentex. Management is also willing to frequently repurchase its shares, and the company should be debt free by the end of 2020 with only $25 million in borrowings outstanding on the credit line. The balance sheet is a fortress in our opinion, with $612.1 million of cash and investments, and continued rollout of new high tech products, such as the full display mirror and the integrated toll module, should lead to strong earnings growth for a while. Upside also exists should aircraft production rebound because the

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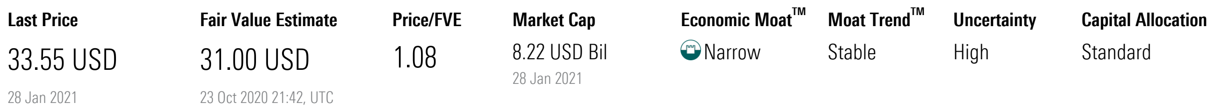

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autodimming windows product currently on the Boeing 787 will eventually get new business from the Boeing 777X and yet to be named Airbus planes per prior Gentex announcements.

The share buyback program has 11.9 million shares of authorization left, and the company repurchased 1.2 million in third quarter at an average price per share of $26.93. We expect the board will not hesitate to authorize more buybacks over time.

Gentex Has a Rare Poor Quarter for Q2, but We Are Not Worried David Whiston, CFA, CPA, CFE, Sector Strategist, 24 Jul 2020

Gentex reported a rare poor quarter, but this is entirely attributable to the severe decline in vehicle production in the second quarter in North America and Europe due to the coronavirus. We have already been modeling conservative figures for 2020 and 2021, so we are leaving our fair value estimate unchanged. Gentex's balance sheet remains a fortress with about $585 million in cash and investments and only $75 million in debt, so we reiterate our opinion that Gentex is one of the safest, if not the safest, automotive stocks to invest in during a recession for the long-term investor.

Revenue and mirror unit shipments fell 51% year over year, which was worse than the quarter's 45% decline in global light-vehicle production but better than the North American and European industry's 69% and 62% respective output declines. Adjusted diluted earnings per share of $0.02 missed the Refinitiv consensus of $0.12. The company took an $8.8 million severance charge to record layoffs across production, research, and corporate positions, which yields annualized savings of $35 million effective as of the third quarter. This expense reduction should help lead to strong earnings once vehicle volume recovers, but for now, no level of cost cuts can catch up with the severe revenue decline, so Gentex could not adequately cover its costs. Gross margin fell to 19.1% from 37.7% in the year-ago quarter.

The recovery is already underway as automaker inventories badly need to be replenished following COVID-19 shutdowns in the spring. Management did not give 2021 guidance and only gave second-half 2020 guidance. The implied full-year 2020 revenue figure is $1.55 billion-$1.59 billion; we have been modeling $1.58 billion. Even if things get worse in 2020, which we think only happens if there's another COVID-19-induced plant shutdown, we do not expect a large fair value estimate reduction after the third quarter because we'd expect Gentex's long-term earnings story to remain intact.

Gentex's Financial Health Remains Excellent Despite COVID-19 Hurting First-Quarter Results David Whiston, CFA, CPA, CFE, Sector Strategist, 24 Apr 2020

We are not changing our Gentex fair value estimate as first-quarter results and the firm's excellent financial health give us no reason to change our thesis. COVID-19 cost the company about $40 million in revenue, a 3.2% year-over-year decline. Annual price reductions given to customers are always a first-quarter headwind, but COVID-19 added to gross margin pressure and caused the metric to fall by 170 basis points to 34.5%. This decline led to less overhead absorption and operating margin fell by 280 basis points to 23.1%. Diluted EPS of $0.36 matched the Refinitiv consensus and fell by 10%.

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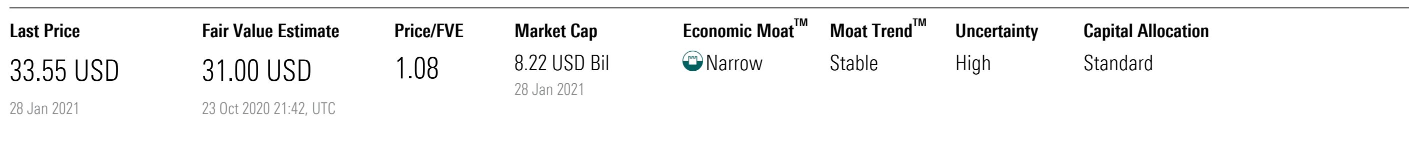

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Management is expecting about a 20% full-year industry vehicle production decline in its key global markets from 2019,and we agree with its expectation of a gradual restart of customers' vehicle production in North America throughout May and June. China is back to just about full speed, and European automaker factories started to resume output this week, so Gentex's factories on a typical day are running at about 30%-50% capacity utilization.

This abrupt production decline from 2019 levels brings new 2020 guidance of revenue of $1.58 billion-$1.67 billion, down from as much as $2 billion previously and gross margin of 34%-35% versus 36%-37% in prior guidance. This new guidance will likely be cut in our opinion should customers not be able to gradually restart production in May and June, but Gentex's nearly $588 million in cash and investments plus $75 million available on the credit line give us no concerns about the firm's health should COVID-19 damage worsen. Management is removing salaried headcount via accelerating retirements and eliminating low performers and intentional staffing cushions. The firm's cash hoard makes us think there's no chance of COVID-19 impacting the dividend. In the first quarter Gentex announced a 4% dividend increase, the tenth straight year of raises.

Premature to Estimate Coronavirus Impact on European Automakers and Global Supply Chain

Richard Hilgert, Senior Equity Analyst, 12 Mar 2020

At this point, it would be premature for us to forecast the full impact of COVID-19 on 2020 automotive sector fundamentals. Both demand and supply chain disruptions will be ongoing until the virus is contained. So far, European automakers have had varying degrees of demand and supply impact. Renault and Peugeot both have facilities in Wuhan, China, which were slated to resume production this week. BMW, Daimler, and Volkswagen as well as nearly all of our auto-parts suppliers have Chinese facilities that saw extended shutdowns after the Lunar New Year holiday. Jaguar Land Rover is airlifting some components from China to keep operating in Europe. Fiat Chrysler also had a supply problem for one European facility but managed a workaround. With Italy's government-directed containment measures, Fiat Chrysler said it would temporarily close Italian facilities where necessary. We do not envision any scenario where COVID-19 affects our midcycle assumptions, and we do not expect any substantial changes to our auto sector fair value estimates.

Coronavirus Not Yet Hurting U.S. Autos, but We Expect Bad News at Least Through April David Whiston, CFA, CPA, CFE, Sector Strategist, 12 Mar 2020

Before the coronavirus pandemic, we were more bearish on 2020 U.S. auto demand than most forecasts, as we explained in our Jan. 30 Auto Observer: Moats, Motors, and Markets. We forecast a decline from 2019 of up to 3.6% to as low as 16.5 million. We expected a continued off-lease surge to move consumers into used vehicles over new, and we still do. The virus' impact on U.S. auto sales is still in its early stages, and there is little data as of March 12 to gauge the impact, so we are not changing our forecast at this time. No North American plants have stopped production yet due to parts shortages, but we expect earnings headwinds from air freight charges and production will be affected if Chinese

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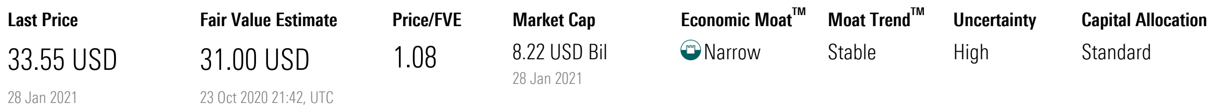

parts plants don't reopen fast enough to keep North American plants moving. We are keeping our forecast in place provided the highest fear levels from the virus subside in the next few months.
We've seen resumption of 0% financing from automakers, such as Chevrolet on certain Silverado pickup purchases, and lower interest rates following the Federal Reserve's rate cut may mitigate some damage. According to Automotive News, citing J.D. Power data, sales in Seattle fell 20% last week, while New York state sales have not been affected. The Central Florida Auto Dealers Association this week said it has seen no virus impact to its members' Orlando stores. Large abrupt declines from a health scare is not surprising to us, but we think it's too early to extrapolate numbers nationally or for the rest of 2020. Still, we expect poor sales numbers in March and April. U.S. light-vehicle sales for the first two months of the year were doing well, albeit helped by high incentives. According to Wards, U.S. sales through February rose 4.5% year over year, with all but three automakers (Ford, Nissan, and Tesla) showing growth. Contrary to what the stock market is doing, we do not think it's time to panic, but uncertainty will remain for a while.

Gentex Keeps Rolling Along to End 2019 Despite Global Uncertainties David Whiston, CFA, CPA, CFE, Sector Strategist, 31 Jan 2020

Gentex finished 2019 with a solid fourth quarter that shows its growth story is not near an end. Diluted EPS did decline year over year by 5% to $0.39 while revenue fell 2%; however, both figures beat the Refinitiv consensus ($0.02 EPS beat). We are not changing our fair value estimate but as always we will reassesses all modeling assumptions after Gentex files its 10-K. Management's 2020 guidance calls for as much as a nearly 8% rise in revenue over 2019's $1.859 billion as the rollout of the high-priced full display mirror continues and auto dimming mirror penetration continues its gradual penetration increase. FDM full-year unit volume grew 89% over 2018 to 739,000 units while total company mirror volume rose 3% to 42.9 million. This 3% growth rate is impressive given management called out an approximate 6% decline in global light vehicle production. 2020 revenue guidance is also well above the industry's light vehicle production based on Gentex citing IHS' negative 1% forecast decline versus 2019 for the combined areas of North America, Europe, Japan, Korea, and China.
As long as the U.S. and Europe do not fall into recession we don't see major problems looming for Gentex this year, though the coronavirus in China may cause further production shutdowns beyond what the industry is already planning for in the first nine days of February. The start of a year also means Gentex starts its annual pricing battle when early in the year it incurs annual pricing reductions from its customers, as is customary in the auto industry. The company then, usually after first quarter, obtains pricing reductions from its suppliers as well as improves its cost structure via finding manufacturing efficiencies. Gentex is very good at this, which is one reason it can keep its gross margins in the upper 30% range.

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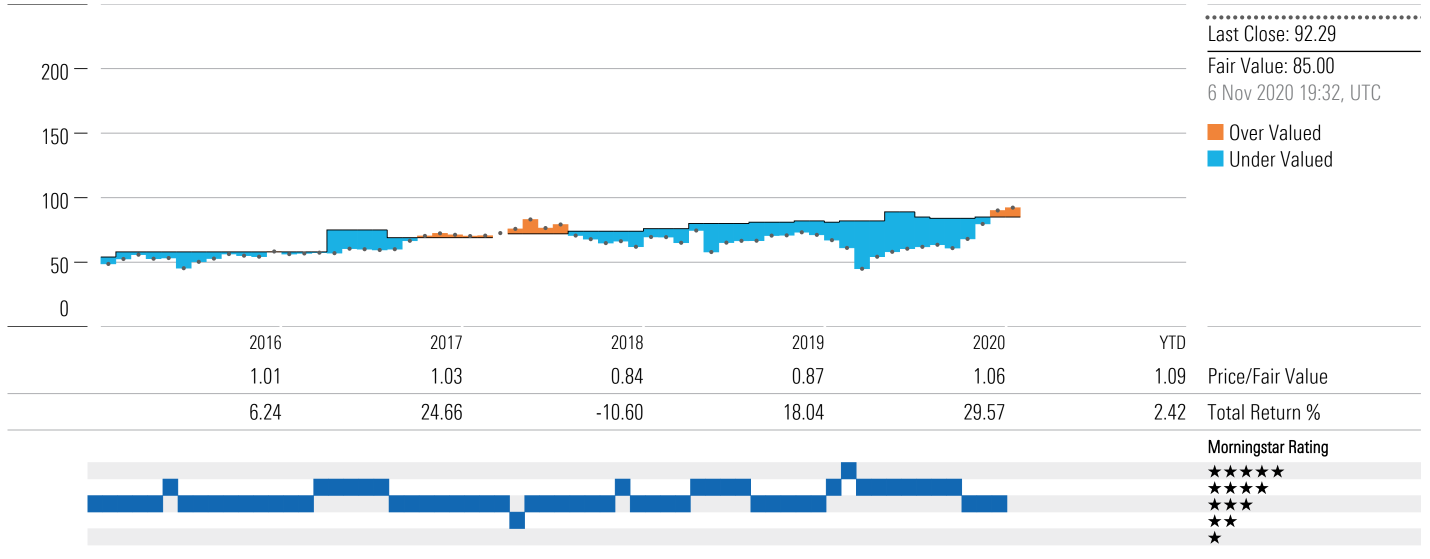
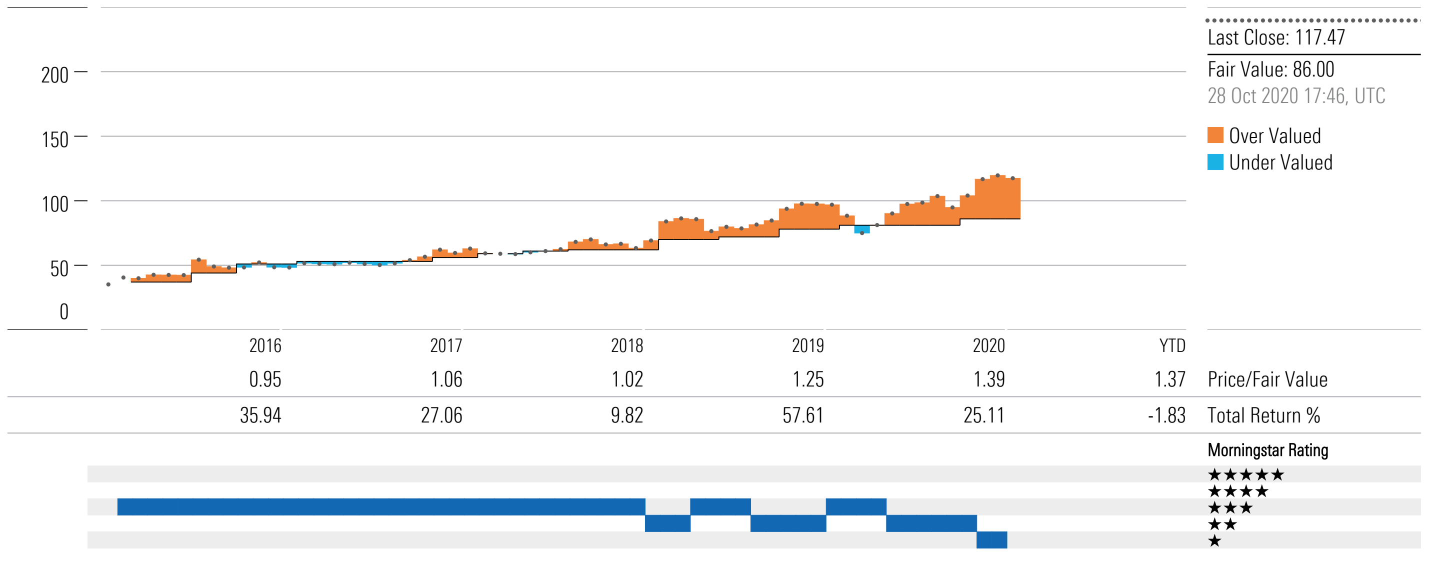
Competitors Price vs. Fair Value

Magna International Inc Class A MG



Total Return % as of 28 Jan 2021. Last Close as of 28 Jan 2021. Fair Value as of 6 Nov 2020 19:32, UTC.

Garmin Ltd GRMN



Total Return % as of 28 Jan 2021. Last Close as of 28 Jan 2021. Fair Value as of 28 Oct 2020 17:46, UTC.

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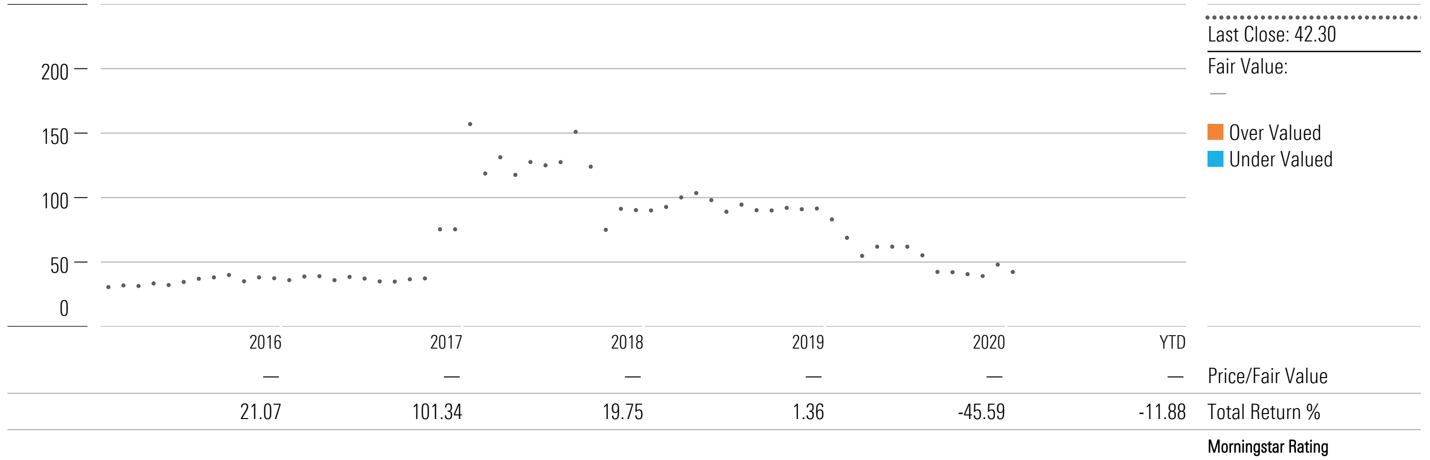
HLJ Technology Co Ltd 3688



	2016	2017	2018	2019	2020	YTD
Price/Fair Value	—	—	—	—	—	—
Total Return %	21.07	101.34	19.75	1.36	-45.59	-11.88

Morningstar Rating

No data available

Total Return % as of 31 Jan 2021. Last Close as of 29 Jan 2021. Fair Value as of —.

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Morningstar Historical Summary

Financials as of 30 Sep 2020

Fiscal Year, ends 31 Dec	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD	TTM
Revenue (USD Mil)	1,024	1,100	1,172	1,376	1,544	1,679	1,795	1,834	1,859	—	1,158	1,602
Revenue Growth %	25.4	7.4	6.6	17.4	12.2	8.8	6.9	2.2	1.4	—	-18.1	-14.3
EBITDA (USD K)	274,003	289,635	367,596	476,210	539,366	600,330	622,929	610,312	593,241	—	315,631	451,903
EBITDA Margin %	26.8	26.3	31.4	34.6	34.9	35.8	34.7	33.3	31.9	—	27.3	28.2
Operating Income (USD K)	231,368	239,455	304,742	398,834	458,766	511,743	523,358	508,126	488,538	—	237,142	348,042
Operating Margin %	22.6	21.8	26.0	29.0	29.7	30.5	29.2	27.7	26.3	—	20.5	21.7
Net Income (USD K)	164,668	168,587	222,930	288,605	318,470	347,591	406,792	437,883	424,684	—	204,224	303,771
Net Margin %	16.1	15.3	19.0	21.0	20.6	20.7	22.7	23.9	22.9	—	17.4	19.0
Diluted Shares Outstanding (K)	288,554	287,936	288,548	294,299	296,238	291,072	288,226	269,877	253,273	—	244,268	245,773
Diluted Earnings Per Share (USD)	0.57	0.59	0.77	0.98	1.08	1.19	1.41	1.62	1.66	—	0.82	1.22
Dividends Per Share (USD)	0.24	0.26	0.28	0.31	0.34	0.36	0.39	0.33	0.57	—	0.24	0.47

Valuation as of 31 Dec 2020

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Recent Qtr	TTM
Price/Sales	4.3	2.5	4.3	3.9	3.2	3.5	3.5	3.0	4.0	5.2	5.2	5.2
Price/Earnings	26.4	16.1	24.6	18.2	15.8	16.4	16.6	12.1	17.5	27.8	27.8	27.8
Price/Cash Flow	26.3	10.5	15.5	16.4	12.4	13.6	13.0	10.2	13.8	18.5	18.5	18.5
Dividend Yield %	1.59	2.71	1.67	1.66	2.06	1.78	1.81	2.13	1.57	1.4	1.4	1.4
Price/Book	4.3	2.4	3.8	3.6	2.8	3.1	2.9	2.8	3.8	4.4	4.4	4.4
EV/EBITDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Operating Performance / Profitability as of 30 Sep 2020

Fiscal Year, ends 31 Dec	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD	TTM
ROA %	15.1	13.8	14.7	15.2	15.3	15.6	17.5	19.7	20.0	—	—	14.0
ROE %	17.2	15.7	18.2	19.9	19.3	19.1	20.5	22.4	22.4	—	—	16.0
ROIC %	17.2	15.7	14.9	16.8	16.8	17.2	20.1	22.4	22.4	—	—	15.8
Asset Turnover	0.9	0.9	0.8	0.7	0.7	0.8	0.8	0.8	0.9	—	—	0.7

Financial Leverage

Fiscal Year, ends 31 Dec	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Recent Qtr	TTM
Debt/Capital %	—	—	16.7	14.1	11.6	8.5	—	—	—	—	—	—
Equity/Assets %	87.3	88.6	75.3	77.7	80.2	82.7	87.1	89.3	89.4	—	86.5	—
Total Debt/EBITDA	—	—	0.7	0.6	0.4	0.3	0.1	—	—	—	0.1	—
EBITDA/Interest Expense	—	—	—	—	—	—	—	—	—	Infinite	—	—

Morningstar Analyst Historical/Forecast Summary as of 23 Oct 2020

Financials

Fiscal Year, ends 31 Dec	2018	2019	2020 (Estimates)	2021 (Estimates)	2022 (Estimates)
Revenue (USD Bil)	2	2	2	2	2
Revenue Growth %	2.2	1.4	-11.7	16.5	15.3
EBITDA (USD Mil)	610	593	465	651	723
EBITDA Margin %	33.3	31.9	28.3	34.1	32.8
Operating Income (USD Mil)	508	489	355	523	582
Operating Margin %	27.7	26.3	21.6	27.4	26.4
Net Income (USD Mil)	438	422	314	446	484
Net Margin %	23.9	22.7	19.1	23.3	22.0
Diluted Shares Outstanding (Mil)	270	253	244	236	230
Diluted Earnings Per Share(USD)	1.62	1.66	1.29	1.89	2.11
Dividends Per Share(USD)	0.44	0.46	0.48	0.52	0.56

Forward Valuation

	2018	2019	2020 (Estimates)	2021 (Estimates)	2022 (Estimates)
Price/Sales	2.9	3.9	5.0	4.3	3.7
Price/Earnings	12.5	17.5	26.0	17.8	15.9
Price/Cash Flow	11.2	17.3	19.8	18.1	16.6
Dividend Yield %	2.18	1.59	1.43	1.55	1.67
Price/Book	—	—	—	—	—
EV/EBITDA	8.0	11.5	16.8	12.0	10.8

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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

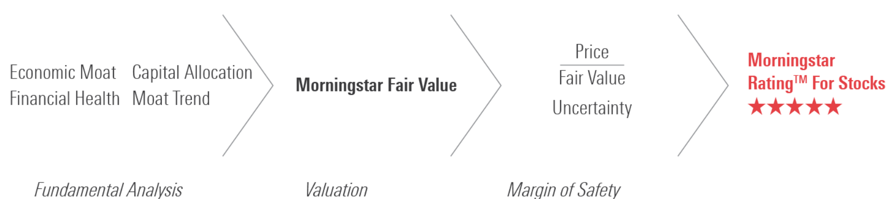
Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it

Morningstar Equity Research Star Rating Methodology



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to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, exposure to material ESG risks, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate. In cases where there is less than a 25% probability of an event, but where the event could result in a material decline in value, analysts may adjust the uncertainty rating to reflect the increased risk. Analysts may also make a fair value adjustment to reflect the impact of this event.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

Qualitative Analysis Uncertainty Ratings	Margin of Safety ★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

4. Market Price

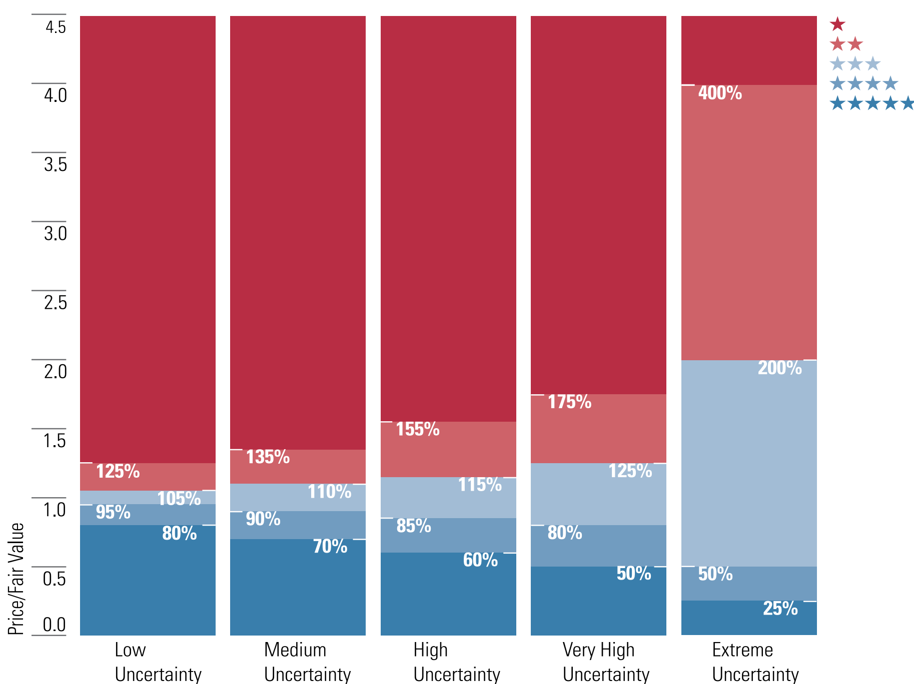
The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com.

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Morningstar Equity Research Star Rating Methodology



Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider compan-

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ies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Risk Warning

Please note that investments in securities are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

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