



Profits in Mirrors Are Larger Than They Appear

We made Gentex Corporation (GNTX: \$32/share) a [Long Idea](#) in [December 2016](#). Since then, the stock has gained 59% while the S&P 500 is up 98%. Despite its underperformance, the stock could be worth \$44/share. Our latest report (April 2019) on Gentex is [here](#).

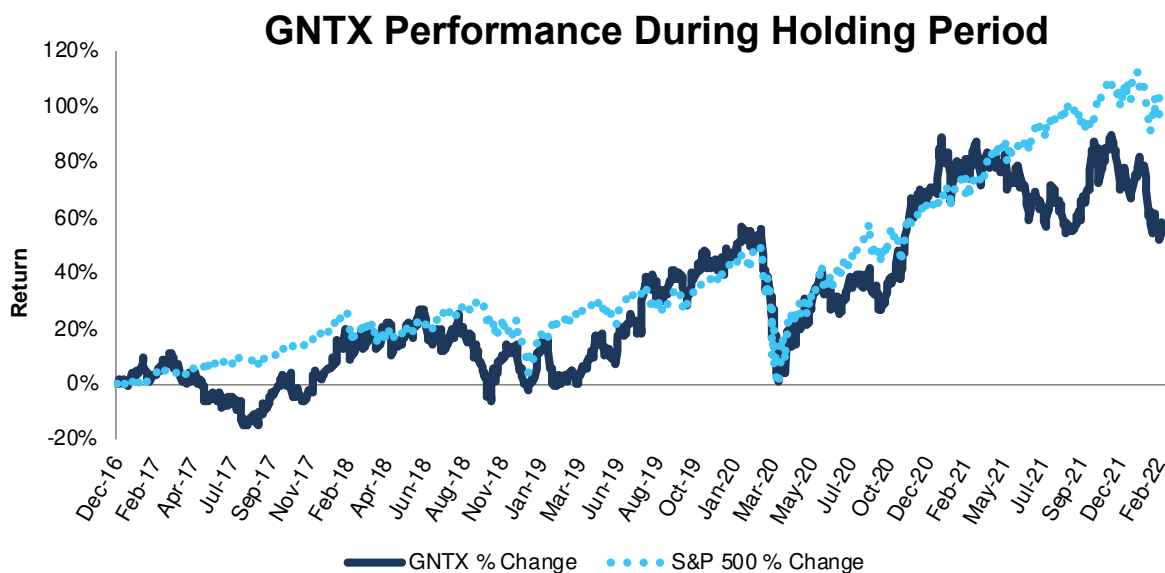
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We leverage more [reliable fundamental data](#), as proven in [The Journal of Financial Economics](#)¹, and shown to provide a [new source of alpha](#), with qualitative research to pick this Long Idea.

Recent Drop Provides Trade Entry Point

- Gentex holds a 94% share of the automatic-dimmable rearview mirror market. Despite fears of product obsolescence, demand for rearview mirrors will persist with the demand for self-driving capabilities.
- Furthermore, investments in new product lines, manufacturing expertise, and deep customer relationships provide growth opportunities for the company.
- Despite its dominant market share and the likelihood of a recovery in light vehicle production, the company's stock is priced as if profits will permanently fall below current levels.

Figure 1: Long Idea Performance: From Date of Publication Through 2/15/2022



Sources: New Constructs, LLC and company filings

What's Working

Recovery From Pandemic Lows Began in 2021: The company began to recover from COVID-related disruption to its business during 2021. Trailing-twelve-month (TTM) revenue of \$1.8 billion grew 15% year-over-year (YoY) in 3Q21, while TTM Core Earnings of \$406 million in 3Q21 represent a 42% YoY increase.

¹ Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).

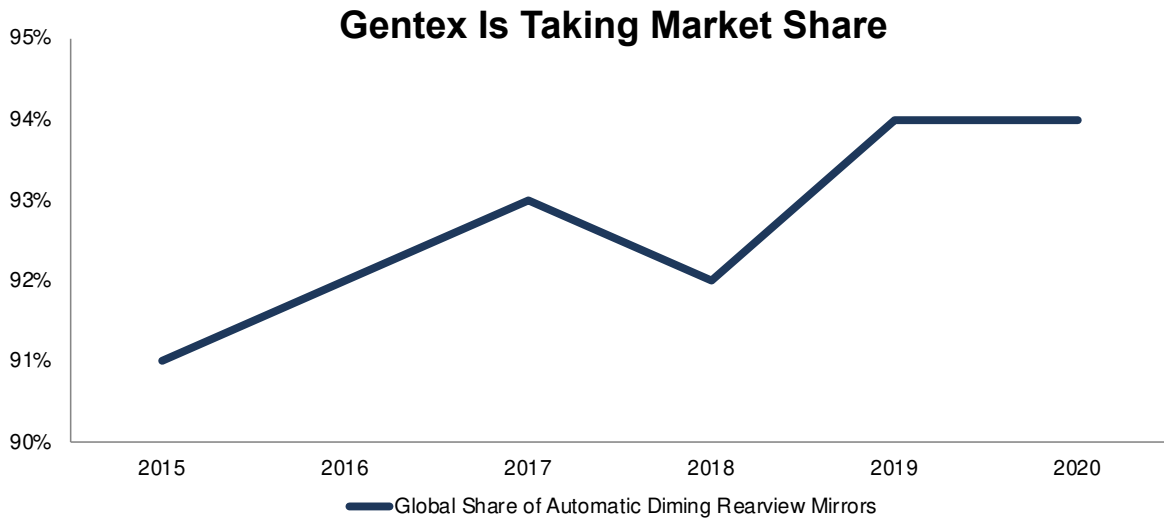


Gentex’s large inventory position going into 2021 insulated it from experiencing product shortages, until 4Q21. As the company was working through its inventory, it completed redesigns that helped it avoid more shortages and total auto-dimming mirror shipments rose from 38.2 million in 2020 to 41.8 million in 2021.

Gentex’s Markets Are Projected to Grow: Gentex is positioned to grow its automotive segment from current levels. [Report Ocean](#) expects the global rear-view mirror market to grow 4% compounded annually from 2021 – 2027, and [IHS Markit](#) forecasts light vehicle production in North America, Europe, Japan, Korea, and China to increase 8% YoY in 2022 and 10% YoY in 2023.

Gentex Dominates the Market: Per Figure 2, Gentex’s share of the [global automatic-dimming rearview mirrors market](#) has steadily risen from 91% in 2015 to 94% in 2020 (latest available figure).

Figure 2: Gentex’s Share of Global Automatic Dimming Rearview Mirror Market: 2015 – 2020



Sources: New Constructs, LLC and company filings

Gentex Is Protected from EV Disruption: While the shift toward electric vehicles (EV) threatens many automotive components, Gentex already supplies EV startups such as Tesla and Rivian. Obviously, the vehicle’s source of power has no effect on the need for a rearview mirror.

Investments Create Growth Opportunities: Despite its dominant market position in automatic-dimming mirrors, the company continues to develop other product lines. Gentex is investing in the following growth opportunities:

- [Full Display Mirror \(FDM\)](#) integrates traditional mirror functionality with rearview camera display. The company’s shipments of FDM grew 7% YoY in 2021.
- [Dimmable glass](#) can have various applications from sunroofs to the interior cabin of passenger planes.
- [HomeLink](#) and HomeLink Connect integrate vehicles with garage doors, home security systems, lights, appliances, and cloud-based home automation services.
- [Smartbeam](#) automatic high-beam assist system.
- [Driving monitoring system](#) that detects changes in driver alertness, gaze location, behavior, and readiness for autopilot return of control.
- [Cabin monitoring system](#) that detects the heartbeat of a child left behind in the backseat of a vehicle.

The company leverages its years of manufacturing experience and deep customer relationships as it looks to grow these offerings.

What’s Not Working

Supply Shortages Slow the Company’s Recovery: Gentex’s revenue fell 21% YoY in 4Q21. Global semiconductor shortages caused 4Q21 light vehicle volume in the company’s primary markets to fall 20% quarter-over-quarter (QoQ) which led to an 18% QoQ reduction in mirror shipments. While problems in the global supply chain negatively impacted the company’s operating results in 2021, we believe disruption to the



company's production is temporary and expect volume, revenue, and most importantly, profits to regain 2019 levels. For instance, management forecasts [pent-up demand](#) for full display mirror products will accelerate that product's sales higher through 2023.

Increasing Costs Pressure Margins: Not only did the company's gross margin fall from 41% in 4Q20 to 34% in 4Q21, but its operating expenses rose 3% over the same time. Higher material, transportation, and labor costs will continue to put pressure on the company's margins.

Falling revenue and rising expenses drive the company's net operating profit after tax ([NOPAT](#)) margin from 25% in 4Q20 to just 19% in 3Q21 and its quarterly return on invested capital ([ROIC](#)) fell from 9% to 5% over the same time.

Threat of Autonomous Driving Disruption Weighs Down the Stock: Autonomous driving and advanced camera technology threaten long-term demand for the company's products. However, level 5 fully autonomous driving is likely many years away. Even if level 5 systems become safe enough to deploy, vehicles will still offer unassisted driving options which would require traditional rearview glass and display features. Plus, consumers are likely to continue to want and, perhaps, at times, need, the option to drive manually even if they sometimes rely on fully autonomous driving technology.

Gentex Is Priced For Permanent Decline in Profits

Below, we use [our reverse discounted cash flow \(DCF\) model](#) to analyze the expectations for future growth in cash flows baked into a couple of stock price scenarios for Gentex.

In the first scenario, we assume Gentex's:

- NOPAT margin falls to 20% (vs. 22% TTM) from 2021 – 2030, and
- revenue grows by 2% (vs. consensus CAGR of 15% for 2022 – 2023) a year from 2022 – 2030

In this [scenario](#), Gentex's NOPAT grows by 2% compounded annually from 2020 – 2030 and the stock is worth \$32/share today – equal to the current price. In this scenario, Gentex's NOPAT in 2030 is just \$404 million, or 2% below its TTM NOPAT.

Gentex's Shares Could Reach \$44 or Higher

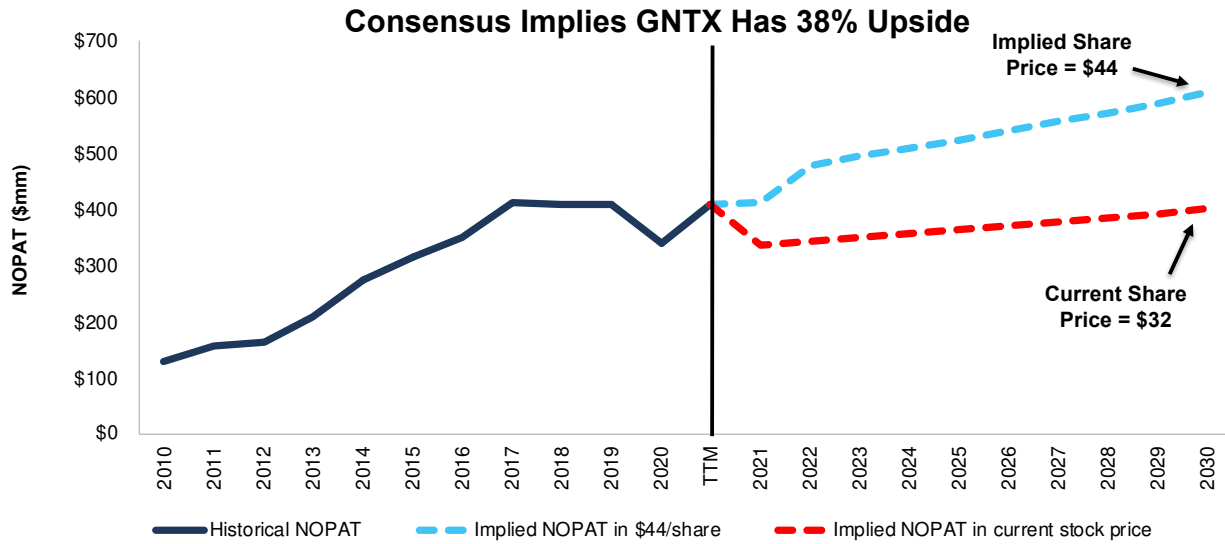
If we assume Gentex's:

- NOPAT margin falls to 21.5% (vs. 22.3% TTM) from 2021 – 2030,
- revenue grows at a 15% CAGR from 2022 – 2023 (equal to consensus), and
- revenue grows by 3% compounded annually from 2024 – 2030 (half its pre-pandemic CAGR of 6% from 2014 – 2019), then

the stock is worth [\\$44/share today](#) – 38% above the current price. [See the math behind this reverse DCF scenario](#). In this scenario, Gentex's NOPAT CAGR from 2019 – 2030 is 4%. For comparison, Gentex grew NOPAT by 8% compounded annually from 2014 to 2019. Should Gentex grow NOPAT more in line with historical growth rates, the stock has even more upside.



Figure 3: Gentex's Historical and Implied NOPAT: DCF Valuation Scenarios



Sources: New Constructs, LLC and company filings

This article originally published on [February 16, 2022](#).

Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.

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1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
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Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms’ data collection processes to provide superior [fundamental data](#), [earnings](#) models, and [research](#). More [details](#).

Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by S&P Global’s (SPGI) *Adjustments* individually.” – pp. 14, 1st para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5th para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3rd para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3rd para.

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