

Jul 31st, 2009

Dear clients and colleagues,

The Q2 earnings season has brought lots of confidence to the market. As of today, 353 companies in the S&P 500 reported. 75% of them beat consensus. The median for positive earnings surprise was 12.9%. In our portfolio, 23 out of 57 companies reported. 96% (all but one) beat consensus, by a median of 20.3%.

Back in our March commentaries we already expected a strong Q2 vs. Q1. The sequential improvement in the bottom line was mainly due to cost cutting and inventory adjustments. Now with leaner corporate and inventory structures, companies face the challenge to grow the top line. Consumer confidence may be getting stronger, but still dragged by high unemployment concern. Although it is difficult to gauge the Q3 results, we believe the economy has bottomed. The recovery will be slow in the US and Europe, and more rapidly in Asia and Latin America.

The company we profile this week is **Gentex Corporation** (GNTX US). www.gentex.com In Q2 it achieved sequential growth in both sales (+25%) and profit (EPS \$0.09 vs. \$0.00), beating consensus by 91.5%.

Founded in 1974, Gentex is a world leading supplier of automatic-dimming rearview mirrors for automotives. Such mirrors automatically darken to reduce glare from the headlamps of vehicles approaching from the rear. The brighter the glare, the darker the mirrors become, making night-time driving safer.

Gentex supplies automatic-dimming rearview mirrors to almost all the major automakers in the world, including Chrysler, Ford, GM, Daewoo, Honda, Hyundai, Infiniti, Kia, Lexus, Mazda, Mitsubishi, Nissan, Toyota, Volkswagen, and Audi. In 2008, it shipped a total of 14.4M mirrors.

Market Data

market cap \$2.1B, no debt, cash \$336M, div yield 2.93%, p/e (12/2009e) 47x, roe 8.3%, ev/t12 sales 3.6x, ev/t12 ebitda 16.1x, gross margin 30.5%, operating margin 13.7%, profit margin 10.4%, 1-year return 1%.

Target Market Size

Currently 65 million light vehicles are produced annually worldwide. Only 19% of them offer an interior electrochromic mirror and just over 6% has at least one auto-dimming exterior mirror. Gentex expects that over the next two vehicle cycles (10 to 12 years) the penetration rate will reach 45%. Based on average mirror of \$100 per vehicle, the potential sales of the

target market is between \$2.5B and \$3B. For reference, Gentex generated sale of \$623.8M in 2008.

Competitive Advantages

Market dominance: Gentex has 83% of global market share in the auto-dimming mirror industry in 2008.

Technology leadership: Gentex owns 16 US trademarks, 278 US patents, 36 foreign trademarks and 129 foreign patents, majority of which relate to electrochromic and electro-optic technology. It is the world leader in electrochromics, the science of reversibly darkening materials by applying electricity. It continues to develop new solution-phase, organic electrochromic materials that variably darken to control the transmission of light through glass.

Growth Drivers:

Product innovation: R&D investment accounts for 8% of net sales, 3 times that of a typical automaker. R&D/technical employees represent 20% of total employees. Its new products such as SmartBeam and Rear Camera Display have contributed to increasing sales.

Favorable legislation: The automakers currently offering a Rear Camera Display product are doing this absent any legislation and made the decision before any was pending. A legislation that was signed into law in February 2008, called the Kids Transportation Safety Act of 2007, orders the Secretary of Transportation at the National Highway Traffic Safety Administration to revise the federal standard to expand the field of view so that drivers can detect objects directly behind vehicles. The phase-in period during which automakers will need to meet the requirements set by NHTSA is expected to be between now and 2016.

Risks

Declines in automotive production caused by general economic slowdown.
Lower margin due to high fixed costs. Pricing pressure from competition.

Investment Theme

A niche leader in a global market with big growth potential: Auto-dimming mirror is not yet widely applied on vehicles. Automotive market in emerging countries is still at early stage.

Valuations

Target price = \$21, using DCF model at growth rate of 12% for 9 years, 6% at maturity, and risk premium of 7%. Expected rate of return is 40%

Have a nice weekend.

The Global Alpha Team