



Is Now a Good Time to Get Involved in the Booming Auto Industry?

Description

Optimism (and demand) in the auto industry keeps growing, and it looks like things are getting better and better. This week, **Ford's** ([NYSE: F](#)) second quarter results beat forecasts with sales rising 15% to \$38.1bln and profit rising 18% to \$1.23bln. Furthermore, management raised its 2013 profit outlook as losses in Europe eased and Asian and South American earnings stayed strong. **General Motors** also reported better than expected second quarter results as strength in the United States and China offset continued weakness in Europe.

According to IHS, light vehicle production will reach 17 million vehicles by 2017 versus 14.5 million vehicles last year. This is close to the highs in the late '90s/early 2000s, and represents a 17.2% year-over-year increase. North American auto companies are operating at close to capacity, and we may begin to hear talk of capacity constraints if demand continues to accelerate and auto makers and suppliers do not adjust quickly enough.

When we cast our gaze beyond North America, we find that a similar scenario exists. Global car and light truck production is expected to hit 100 million vehicles by 2015 from 80 million this year. That's a very strong 20% 2 year growth rate.

What is fueling auto demand?

In the United States, the housing/economic recovery has given consumers the financial ability to replace their old cars. And given that the average age of vehicles on the road is 11 years, we can understand why there is motivation to do so. In other parts of the world, such as China, India and South America, it's the emerging middle class that is fueling demand.

A way to play the surging global auto industry

Being a supplier to many different auto manufacturers (OEMs), Magna (TSX:MG,NYSE:MGA) has exposure to the entire auto industry. Relative to the OEMs, Magna is less sensitive to a specific brand or class of car, which helps mitigate risk – a good thing for investors.

The following charts provide a glimpse of the diversified nature of Magna's business.

Magna segment sales

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Magna customers

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Magna's primary markets are North America and Europe. In 2012, Magna's North American production sales increased 10%, while European production sales increased 2%. The rest of world segment climbed a whopping 31%, albeit from a smaller base. Magna's strategy going forward is to increase its presence in the fast growing "rest of the world" category. Good thinking!

Moving right along. Now let's turn to Magna's balance sheet to determine if the company has the ability to comfortably do this. Magna has an extremely healthy balance sheet, with a debt to capitalization ratio of just under 4%. Perfect! Magna has the financial capacity to make acquisitions or invest in organic growth to strengthen its position in the "rest of world".

In terms of profitability, at 16%, Magna has the strongest ROE in its peer group. Canadian peers **Martinrea Int'l** ([TSX: MRE](#)) and **Linamar** ([TSX: LNR](#)) sport ROEs of about 8% and 14% respectively. Magna also outshines its peer group with respect to its balance sheet. Both Martinrea and Linamar have high debt levels (over 40% debt to capitalization ratios), and therefore are somewhat limited in their growth plans.

EPS growth and valuation comparison

Magna wins on profitability and wins on balance sheet, but let's see how it stacks up on two more

measures – namely growth, and valuation.

Company Name	Est. EPS Growth		P/E	
	2013e	2014e	2013e	2014e
Magna	3.7%	19.0%	12.6	10.6
Linamar	23.7%	10.1%	11.4	10.4
Martinrea	24.4%	20.5%	10.7	8.9
Uni-Select	-8.8%	24.5%	10.2	8.2

Even though Magna is open to a world of opportunity, it's the 200-lb gorilla of this group, and therefore, moving the needle is more of a challenge. With that being said, somewhat remarkably, in 2014, Magna is set to grow at a similar rate to that of its smaller, more nimble peers. And for this projected growth, you're paying a seemingly low multiple.

Foolish Bottom Line

In my view, given its diversified business, sound metrics, strong balance sheet, and projected growth Magna warrants a more significant multiple premium than the one that currently exists. I look for this gap to widen in the coming years as the auto industry continues to roar.

Magna is a great Canadian success story born out of humble beginnings. To learn of 3 more companies that started small and now dominate their respective industries, [click here](#) and we'll send you our special **FREE** report "**3 U.S. Stocks Every Canadian Should Own**" – **FREE!**

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Fool contributor Karen Thomas does not own shares of any of the companies mentioned at this time. David Gardner owns shares of Ford. The Motley Fool owns shares of Ford.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:F (Ford Motor Company)
2. NYSE:MGA (Magna International Inc.)
3. TSX:LNR (Linamar Corporation)
4. TSX:MG (Magna International Inc.)
5. TSX:MRE (Martinrea International Inc.)

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