The Stock Picker's Guide to Martinrea International for 2014

Description

Martinrea International (TSX:MRE) shares may have tacked on 13% year to date, but investors aren't sure whether they should cheer or panic. The auto supplier's past quarter, after all, was nothing short of a roller-coaster ride.

After reporting a bumper third quarter in November last year, Martinrea shares tumbled 21% on a single day in December after the company disclosed that the profits for one of its plants have been overstated since 2005. Martinrea stock has surprisingly bounced back ever since, but is the market getting excited a little too early, or is this euphoria meant to last? Let's dig deeper.

Unanswered questions
The accounting error could have serious implications to Martinrea's goodwill and image. While management claims to have identified the discrepancy during "an ongoing review" of business and doesn't consider it a setback, the incident raises doubts about the company's financial integrity. To top that, former vice chairman Nat Rea recently accused some Martinrea executives of making payments to outside parties for company-related transactions. If any of those allegations are substantiated, Martinrea's reputation could nosedive.

Both cases are still being investigated, so investors should remain cautious. Any negative development could send Martinrea shares plummeting. But given the stock's rally so far this year, it looks like the market has already chosen not to pay much heed to these issues, and bet on the company's good financial performance instead.

The silver lining
Martinrea delivered its best-ever third quarter in November last year, with adjusted net income surging 52% year over year on 10% higher revenue. Gross margin improved two-and-a-half percentage points to hit 10.9% during the quarter. In fact, Martinrea's profitability has improved dramatically over the past year. Take a look at the chart below.

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While product launch-related expenses in the back half of 2012 made year-over-year comparison look rosier, Martinrea's ongoing restructuring and cost-cutting initiatives also played a role in driving profits up. In fact, most auto suppliers are falling back on cost-cutting to boost margins. For instance, industry leader **Magna** (TSX:MG)(NYSE:MGA) also shut down some operations in Europe, hoping to gain half a percentage point on its operating margin in 2014.

Growth catalysts

The good news is that Martinrea has been able to tide over industry challenges better than Magna, thanks largely to its geographic sales mix. While Magna gets 40% sales from Europe, nearly 80% of Martinrea's sales originate from North America. Naturally, the recent uptick in auto sales in the U.S. worked in Martinrea's favor.

Moreover, Martinrea's sales from Europe jumped 9% for the nine months ended September 30, 2013, thanks to higher production and robust demand for aluminum parts from key customer, Jaguar LandRover. Martinrea is also enjoying strong demand from Brazil, and it entered the Chinese market last quarter with its new product for Ford's CD4 platform.

So where's Martinrea stock headed?

Robust auto markets and new launches should boost Martinrea's top line. And as long as the company can control costs, its profits should continue to grow as well. After a record 2012, Martinrea expects to set a new high for the financial 2013 and beyond. The company also started paying out a dividend last year, which is great news for investors.

But thanks to the unfortunate developments pertaining to the overstating of results and lawsuit, Martinrea's story has suddenly gone murky. So while the company is operationally performing well, investors should be prepared for a volatile 2014.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:MGA (Magna International Inc.)
2. TSX:MG (Magna International Inc.)
3. TSX:MRE (Martinrea International Inc.)

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