



3 Reasons to Stay Away From Magna International

Description

In 1957, Austrian immigrant Frank Stronach started **Magna International** ([TSX: MG](#))([NYSE: MGA](#)) out of a Toronto garage. After merging with a competitor in 1969, the new combined company couldn't be stopped.

It currently is North America's largest auto parts manufacturer, supplying parts to every major auto manufacturer that has production on the continent. 2013 saw the company set records for revenue and profit, with both numbers coming in at \$34.8 and \$1.5 billion, respectively. Magna has ridden the wave of recovering North American auto sales.

The company is considered a leader in electrical engine technology. It took the initiative to convert a Ford Focus to a fully electric engine — at its own expense — and drove the car to **Ford's** headquarters to pitch executives. The big bosses at Ford were so impressed they gave Magna the contract to supply the drivetrain for the 2011 all electric version of the Focus, and Magna continues to work closely with Ford on electric engine technology going forward.

There is little doubt in my mind Magna is a world-class company. However, it's got a few major red flags that stop me from buying shares.

1. Executive pay

When I look at how well Magna pays its senior executives, one word comes to mind: ridiculous.

When the company finally bought out the founder's voting share of the company in 2010, it paid him \$860 million. While 75% of the company's shareholders did approve the deal, four major institutional shareholders went on record voicing their displeasure with the deal. Words such as "unreasonable" and "fundamentally unfair" were thrown around at the time. This event nicely represented years of Stronach using his controlling stake in the company to pay himself outlandish salaries.

Fast forward three years, and it turns out the company paid Stronach \$52 million (U.S.) in consulting fees in 2013, 2.25% of profit. 2014 is the last year the company is scheduled to pay Stronach to consult, the rate is currently scheduled to be 2% of profits.

The company has taken steps going forward by capping executive compensation at 3% of the company's profit. Still, company execs made more than \$45 million in 2013, excluding Stronach. Time will tell whether the company is serious about reducing excessive pay to its top brass.

2. Tesla

One of the reasons Magna's stock price has done so well over the past few years is the company's aggressive move into components for electric vehicle technology.

Meanwhile, **Tesla** ([NASDAQ: TSLA](#)) gets all the attention in the space because of its sexy new electric cars. Everybody wants to drive the newest Model S, and the company has plans to release a much cheaper Model E into the market by 2017, expanding the market significantly.

The part of Tesla's business that doesn't get much attention is the company's relationship with **Toyota** and **Honda**, manufacturing drivetrain components for their electric and hybrid vehicles. If Tesla emerges as a serious competitor in this space, it could take away much of Magna's growth potential going forward.

3. Sector performance

While I'm usually more interested in what a stock is poised to do going forward, I can't help but notice how well the entire auto parts sector has done since the financial crisis of 2008-09.

Shares in competing parts manufacturers **Martinrea** ([TSX: MRE](#)) and **ATS Automation** (TSX: ATA) join Magna as companies that have increased more than 250% from their 2009 bottom. With the notable exception of Ford, the car manufacturers themselves haven't enjoyed the same kind of share outperformance as the parts makers.

The last few years have indicated the parts manufacturers are a leveraged play on vehicle sales. At some point, investors are going to get out of the space. The money has already been made. I'd look to cycle my exposure to the sector into a car manufacturer if I had exposure to any of the parts companies.

Foolish bottom line

Things are looking pretty good for Magna. Vehicle sales are brisk, its electric engine technology continues to sell, and the company is finally close to not paying Frank Stronach. I just get nervous investing in a company that has enjoyed such a huge share price appreciation. If I had shares in Magna, I'd sell and look for other opportunities.

CATEGORY

1. Investing

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1. NASDAQ:TSLA (Tesla Inc.)
2. NYSE:F (Ford Motor Company)
3. NYSE:MGA (Magna International Inc.)
4. TSX:ATS (Ats)
5. TSX:MG (Magna International Inc.)
6. TSX:MRE (Martinrea International Inc.)

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