Why Magna International Inc.'s Stock Zoomed 10% Last Week

Description

Magna International Inc.'s (TSX:MG)(NYSE:MGA) stock gained as much as 10% last week after the auto parts manufacturer announced its first-quarter results on May 7. Interestingly, Magna's Q1 numbers leave little room for excitement as the company reported lower sales and even downgraded its full-year sales outlook. So, why is the stock flying higher, and what should you make of it?

Lower revenue, but higher profits

At first blush, it's worrisome to know that Magna's Q1 sales dropped 7% year over year. But when digging deeper, it becomes clear that nearly the entire drop was a result of currency fluctuations and not weak demand. Since Magna has wide global presence, a stronger dollar translates into lower revenue earned from international markets. In fact, excluding currency fluctuations, Magna's sales were up 3% year over year.

What's really encouraging is to see Magna's profits grow despite lower sales. Its Q1 net income jumped 18% year over year, backed by lower costs and incremental margins on products launched over the past year. A growing bottom line is perhaps one of the biggest reasons why the market applauded Magna's Q1 report and sent its stock higher.

Growing profits could also explain why a lower sales outlook from Magna isn't scaring investors away. The company now expects to generate sales between US$30.8-32.5 billion this year versus its earlier projected sales range of US$33.1-34.8 billion. That's substantial downgrade, but again, it's worth noting that it comes on the back of currency headwinds. Magna continues to project strong growth in China, coupled with modest sales growth in North America and Europe for 2015.

Solid steps for future growth

Aside from the numbers, Magna's last quarter was significant because of its growth plans. The company announced plans to sell its interiors operations, which includes 36 manufacturing facilities and nearly 12,000 employees, for roughly US$525 million.

This deal is in line with Magna's efforts to do away with non-core operations so it can focus on key profitable business areas. Investors may recall that the company recently offloaded its battery pack business to Samsung after selling off a nonautomotive-composites business last year.

In another recent development, Magna struck an agreement with China-based Chongqing Xingqiaorui earlier this month to set up a joint venture to supply auto body and chassis parts. China is emerging as Magna's key growth market; strong demand from the nation boosted the company's Q1 sales by 10% year over year. Needless to say, the joint venture could give Magna great foothold in the high-potential Chinese automotive market.

On the one hand, Magna is divesting non-profitable businesses, and on the other, is spreading its wings in key growth markets. This well-balanced strategy should help the company earn good returns on its investments going forward.

What you should do

Magna has proved its mettle yet again with another solid quarter of growing profits despite lower revenue. The company is growing aggressively, generating strong cash flows, and earning good returns for shareholders. In line with such solid fundamentals, Magna shares have consistently outperformed the broader market over the past five years, and there's no reason why it shouldn't continue to do so. I strongly urge you to add Magna stock to your radar if you still haven't done so.

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