Don't Ignore Magna International Inc. and its Massive Dividend-Growth Potential

Description

It hasn't been a whole lot of fun for **Magna International Inc.** (TSX:MG)(NYSE:MGA) shareholders of late. In the last six months shares of the auto parts giant are down more than 37% compared to a loss of just 12% for the TSX Composite.

So what happened? Although Magna's results have been solid and the company looks poised to benefit from the lower loonie, that hasn't been enough to overcome the market's souring of the whole automotive sector. Cars are a cyclical business, and with economies around the world struggling–especially China–investors are concerned the industry is due for a big slowdown.

You wouldn't know it looking at Magna's numbers. Yes, revenue was down, falling from US$8.25 billion in 2014 to US$7.66 billion in its most recent quarter, but remember the majority of its plants are located in Canada and results are in U.S. dollars. So once we strip out the currency fluctuations, it isn't that bad.

Besides, the bottom line was fine. Net profit came in at US$589 million in the quarter compared to US$470 million the year before, which works out to $1.14 per share.

On an annualized basis, earnings look good, too. The company has earned $6.52 per share, putting it at just 7.1 times trailing earnings. Analysts are still bullish for 2016, predicting earnings will come in at $7.32 per share. That puts Magna at just 6.3 times forward earnings.

Any way you slice it, Magna is cheap. And even if earnings do slow because of a prolonged slump in the automotive sector, the company is certainly strong enough to survive. It has a pristine balance sheet with US$2 billion in cash compared to US$1.6 billion in total debt. That's exactly what you want to see in a company that's in a cyclical industry.

There's one other reason why investors should really look closely at Magna today, and that's the company's massive dividend-growth potential.

Dividend potential

After temporarily suspending its payout during the financial crisis of 2008-09, Magna has been a terrific dividend grower. It started paying a US$0.045 quarterly dividend in 2010 and has increased its distribution annually each year since. These days the dividend is US$0.22 each quarter. This works out to a current yield of approximately 2.5% once it's converted back to Canadian dollars.

That's just the tip of the iceberg. When we convert Magna's per-share earnings back to U.S. dollars, we get trailing 12-month earnings of US$4.74, meaning Magna's payout ratio is a paltry 18.6%.

Even if Magna doesn't grow earnings for a decade–which is highly unlikely considering a number of factors, but hear me out–and it grows the dividend 20% each year, it will still have enough earnings to cover dividends for nine of the 10 years with enough retained earnings left over to cover that 10th year.

And after a decade the annual dividend would work out to US$5.45 per share, good enough for a yield on cost of more than 16% when looking at today's price.

I'm not saying Magna will increase the dividend by 20% a year for a whole decade. It might decide there are other uses for its cash. But it's really easy to see the potential in the dividend going forward. Even if investors can get a 10% raise each year, I bet most would be happy.

Dividend-growth investing can take a couple of different forms. For many investors it involves buying tried-and-true champions with decades of consistent dividend increases. But perhaps that's the wrong way to look at it. Instead, the strategy could be finding stocks with good long-term potential, minuscule payout ratios, and management teams who are committed to giving shareholders an annual raise.

Magna has all three of these qualities, which is why dividend-growth investors should consider it for a long-term hold. The recent sell-off in price is just the icing on the cake.

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