Will Auto Stocks React to Better-Than-Expected Jobs Report and Strong Auto Sales?

Description

Strong jobs reports in both the U.S. and Canada this month as well as strong auto sales increases this year have gotten me thinking about cyclical auto stocks.

In Canada, the unemployment rate fell by 0.2 percentage points to 6.6% in February, as more than 15,000 jobs were created. Importantly, most of the gains came from full-time work, but the wage gain was only a disappointing 1.3%.
In the U.S., 235,000 jobs were created, and the unemployment rate fell to 4.7%.

Canadian auto sales increased 3.2% in February versus last year, and in the U.S., 2015 and 2016 were record years with auto sales of 17.5 million and 17.55 million cars and trucks, respectively.

So, while we can all be cautious on future auto sales and the eventuality of sales peaking, the job numbers certainly light a fire under the automotive sector.

Which stocks are the best way to play this?

Martinrea International Inc. (TSX:MRE)

Martinrea is a $798-million-market-cap auto parts company with a 1.24% dividend yield. The stock trades at a P/E of 5.5 times this year's earnings despite its 17% expected earnings growth rate, and it trades pretty much at book value. It's a very cheap stock with an ROE of 11.5%, free cash flow of $33 million in 2016, and improving margins.

The 2016 gross margin was 10.9%, which is up from 10.4% in 2015 and 9.7% in 2014. And 2016 sales increased 2.6%, but EPS increased 9.5%. The balance sheet is a little stretched with a debt-to-total-capitalization ratio of 46.5%, but this appears manageable.

Linamar Corporation (TSX:LNR)

Linamar is a $3.9-billion-market-cap auto parts company with a 0.66% dividend yield. The stock trades at a P/E ratio of 7.6 times this year's earnings, which are expected to be marginally below 2016 earnings. EPS is expected to increase 6% in 2018. The company has a very strong ROE of over 20%, and its balance sheet is also a little stretched with a total debt-to-capitalization ratio of 40%.

Magna International Inc. (TSX:MG)(NYSE:MGA)

Magna, the best known of the auto parts companies, has a market capitalization of $21.8 billion and a dividend yield of 2.56%. Perhaps it's the most stable of the auto parts companies, but it's also the most highly valued. The stock trades at a P/E of 10 times this year's earnings with a 7.8% 2017 expected earnings growth rate. Magna is a well-run company with a strong balance sheet which will be deployed in acquisitions, dividend increases, and share buybacks.

While all of these companies have their merits, at this time, I like Martinrea best due to its rock-bottom valuation and good recent financial performance.

CATEGORY

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