Forget Magna International Inc.: Invest in Martinrea International Inc. Instead

Description

Martinrea International Inc. (TSX:MRE) reported its first-quarter results today, and they were above expectations. Management highlighted the fact that the future is looking bright.

While sales declined 3.7% to just over $1 billion due primarily to weakness in North America, it is worth noting that a big chunk of the weakness was due to foreign exchange translation, which had an approximate $33.7 million drag on sales. Also, sales in Europe were a positive this quarter; sales increased a healthy 4.6% due to increased tooling sales, increased production from its new facility in Spain, and higher volumes in Germany. Although Europe represents only 17% of sales, the increase is definitely a success for the company.

Martinrea made good progress in increasing margins and efficiencies across the company. the gross margin was 11.8% in the quarter — a full percentage point increase from the same period last year, and selling, general, and administrative expense fell 2.2%. For comparison purposes, and to illustrate how effective the company has been in increasing margins, we should note that 2016's gross margin was 10.9% — up from 10.4% in 2015 and 9.7% in 2014.

Looking at the cash flow statement, we see that the company generated almost $107 million in the quarter, which represents a healthy 11% of sales. Free cash flow was $20 million.

Balance sheet strengthening

The company's long-term debt declined $30 million to $667 million, and its long-term debt-to-equity ratio declined to 77% from 84% last year. The ratio is high, but it's manageable considering the amount of free cash flow the company is generating.

Valuation remains attractive

The stock trades at a P/E ratio of 7.3 times last year's earnings and 6.2 times this year's expected consensus earnings, despite its 18% expected 2017 earnings-growth rate, and it trades at 1.1 times book value with an ROE of 11.5%. With free cash flow of $33 million in 2016 and $20 million in the first quarter of 2017, and improving margins, it is my view that this is a very cheap stock despite yesterday's run-up.

Comparing this to **Magna International Inc.** (TSX:MG)(NYSE:MGA), we see that Magna trades at a P/E of over 10 times last year's and this year's earnings, and it has a 7% consensus earnings-growth rate expectation for this year. And although Magna has a very healthy ROE and less debt, the company appears to have less room for margin improvements at this point, and it has been performing below expectations. Magna will be reporting its first-quarter results on May 11.

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