Why Magna International Inc. Is Still a High-Risk Play

Description

Magna International Inc. (TSX:MG)(NYSE:MGA) is up over 20% this past year, but it's still down about 16% from its 2015 high. In previous pieces, I've taken a bearish tone on the company because of the potential impact that a Trump border tax could have on the business. While this is a good reason to avoid the company completely, there are positive developments that may offset the pessimism over the short to medium term.

Some positive developments

Looking ahead, global vehicle production is expected to increase thanks to a strengthening U.S. economy. Magna is well equipped to capitalize on this trend with its strong manufacturing operation and a solid balance sheet. As Magna continues to invest in manufacturing operations, margins are likely to increase, which better positions the company to ride the increased demand for vehicles.

Dirt-cheap shares

Many value investors consider Magna as one of their top value stocks because of its low valuation multiples. At the time of writing, Magna has an 8.66 price-to-earnings multiple, a 1.8 price-to-book multiple, a 0.5 price-to-sales multiple, and a 5.3 price-to-cash flow multiple, all of which are lower or in line with the company's five-year historical average multiples of 10.8, 1.8, 0.5, and 7.8, respectively. The dividend yield is also considerably higher at 2.45% than its average yield of around 1.8%.

The stock is the cheapest it has been in many years, but still, I don't believe there's a margin of safety at current levels as the potential risks are still present.

Border tax risk still a potential long-term headwind

The Trump administration's protectionist tone is nothing but bad news for foreign auto parts makers like Magna. We can only speculate as to what the terms will be if Trump implements a border tax, but if the worst-case scenario comes to fruition, Magna could be heading to much lower levels from here.

Sure, Magna could move its facilities to operate within the U.S. to avoid the Trump tax which could be as high as 20%, but let’s be realistic. This is going to be an expensive initiative which may not be worth it over the very long term if the plan is to just avoid paying a border tax over the next few years.

Bottom line

Although Magna is extremely cheap and some positive developments are coming up, I still think an investment in Magna is a risky proposition thanks to the uncertainty following border taxes.

While it’s too early to jump to conclusions at this stage, I would probably just wait on the sidelines because further bad news regarding border tax readjustments may send Magna plunging to new 52-week lows. Shares are cheap, but they’re cheap for a reason.

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