Is Magna International Inc. About to Drive Off a Cliff?

Description

Shares of **Magna International Inc.** (TSX:MG)(NYSE:MGA), along with the rest of the TSX, haven't really gone anywhere this year. The stock appears to be a steal with its mere 8.26 price-to-earnings multiple, but investors should exercise caution because shares are cheap for a reason.

Auto sales south of the border have gone down for five straight months as of July, and the much-anticipated pro-growth agenda proposed by President Trump is starting to look like it may never come to fruition. To add more salt in the wound, it's still likely that Trump is going to slap on a hefty tax on foreign auto part producers like Magna with the hopes that more American jobs will be created in the effort to "make America great again."

Cheap according to traditional valuation metrics

If you're a value investor looking for blue-chips stocks, then Magna is probably on your radar. The stock is the cheapest it has been in many years, and the dividend yield is starting may soon start to attract income investors as the yield continues to move closer to the 3% mark.

Shares currently trade at an 8.26 price-to-earnings multiple, a 1.6 price-to-book multiple, a 0.46 price-to-sales multiple, and a five price-to-cash flow multiple, all of which are considerably lower than the company's five-year historical average multiples of 10.8, 1.8, 0.5, and 7.8, respectively. The dividend yield, currently at 2.41%, is also quite a bit higher than the historical average yield of 1.8%.

According to traditional valuation metrics, Magna is an absolute steal, but I remain skeptical.

Sure, shares are cheap, but is Magna really a top-notch business with a durable competitive advantage? Or is it a potential value trap which presents a huge risk with major headwinds on the horizon?

Personally, I think it's the latter. Although shares are cheap, I think it's quite probable that shares could plunge further and become even cheaper.

Even if U.S. auto sales picked up, Magna would still have to move a lot of its products across the border, which may be subject to a fat border tax. NAFTA renegotiations are something that Canadian auto parts investors should be afraid of. While we shouldn't jump to conclusions about what the Trump administration will do, I think it'd be a wise move to be out of the stock because there's real potential for a major downfall, especially considering President Trump's aggressive nature.

Bottom line

U.S. auto sales are slowing down, but that's not the real reason why Magna may be a value trap. A larger-than-expected border tax will wreak havoc on Magna's bottom line. Sure, the company could move some production into the U.S., but that's an expensive endeavour that probably won't offset the short- to medium-term pain that the business will likely experience.

Shares are cheap, but I just don't see how Magna can rally from here, so I'd stay on the sidelines, no matter how cheap the stock gets over the next few months. The uncertainty and risks involved are simply not worth the potential rewards.

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joefrenette